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Financial Regulation Strategy
HM Treasury
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London
SW1A 2HQ

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18 October 2010

Dear Sirs,

HM Treasury – A New Approach to Financial Regulation: Judgement, Focus and Stability

INTRODUCTION

The Quoted Companies Alliance (QCA) is a not-for-profit membership organisation working for small and mid-cap quoted companies. Their individual market capitalisations tend to be below £500m.

The QCA is a founder member of European**Issuers**, which represents over 9,000 quoted companies in fourteen European countries.

The QCA Markets and Regulations, Legal and Corporate Finance Advisors Committees has examined your proposals and advised on this response. A list of committee members is at Appendix A.

RESPONSE

We welcome the opportunity to respond to this consultation. As an organisation that represents small and mid-cap quoted companies and those aspiring to join a UK public market, we are primarily concerned with the proposals in the paper surrounding markets and infrastructure and in particular, the question of where the UK Listing Authority (UKLA) should sit in the new regulatory structures proposed. As such, we will focus our response on the following questions:

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

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

As highlighted by HM Treasury's recent consultation 'Financing a Private Sector Recovery', it is essential that the UK has a flexible and robust system for raising finance for smaller companies, and the UKLA has an important role to play in facilitating this system.

We have reservations about the UKLA continuing in its current form. We hope that the future reorganisation of the regulatory structure is used as an opportunity to improve and support the structure and culture of the UKLA.

We believe that, wherever the UKLA is placed following the breakdown of the Financial Services Authority (FSA), it should encompass the following characteristics:

- focus on primary markets as being distinct from secondary markets, while maintaining a close connection to, and understanding of, both primary and secondary markets.

- have a strong voice in Europe, evidenced by effective representative on and input into the new European Securities and Markets Authority (ESMA).

- foster a culture that is close to the market. In particular, the UKLA needs to attract market practitioners to allow it to keep in touch with market practice and to make it a commercially-aware body. For example, this could be achieved through bringing in secondees from corporate finance / broking houses, accountants, law firms, etc, similar to a model now used by the Takeover Panel. Bringing in secondees would help the UKLA to better be able to understand not only the markets, but also the culture, operation and concerns of companies.

- adopt a transparent, workable and flexible approach on the timing of paperwork turnaround.

- make decision-making powers transparent and decision-makers more available.

- foster an appropriate and proportionate approach to the regulation of small and mid-cap quoted companies.

- operate as an independent entity within the regulatory authority in which it resides.

We believe that the function of the UKLA will be better suited as part of the Consumer Protection and Markets Authority (CPMA), rather than the Financial Reporting Council (as suggested in the consultation paper). Under the CPMA it will be better able to remain close to primary and secondary market issues within the markets regulator and be able to participate directly in the formation of European policy through the CPMA's seat on ESMA. It will be important to ensure that if the UKLA were to move to the CPMA, it is not disproportionately influenced by the consumer protection aspect of the Authority. There needs to be a balanced view taking account of the needs of the market and companies.

If you wish to discuss any of these issues with us, we will be pleased to attend a meeting.

Yours faithfully,

Tim Ward
Chief Executive

APPENDIX A

QCA MARKETS AND REGULATIONS COMMITTEE

Stuart Andrews (Chair)	-	Evolution Securities
Umerah Akram	-	London Stock Exchange plc
Peter Allen	-	DWF LLP
Andrew Collins	-	Speechly Bircham LLP
Jonathan Eardley	-	Share Resources plc
Richard Everett	-	Lawrence Graham LLP
Martin Finnegan	-	Nabarro LLP
Alexandra Hockenhull	-	Hockenhull Investor Relations
Farook Khan	-	Pinsent Masons LLP
Linda Main	-	KPMG LLP
Richard Metcalfe	-	Mazars LLP
Katie Morris	-	Brewin Dolphin Ltd
Simon Rafferty	-	Winterflood Securities
Chris Searle	-	BDO LLP
Peter Swabey	-	Equiniti LLP
Theresa Wallis	-	LiDCO Group
Tim Ward	-	The Quoted Companies Alliance
Kate Jalbert	-	The Quoted Companies Alliance

QCA LEGAL COMMITTEE

Tom Shaw (Chairman)*	-	Speechly Bircham LLP
Jai Bal	-	Farrer & Co LLP
Chris Barrett	-	Bird & Bird LLP
Richard Beavan	-	Nabarro LLP
Matt Bonass	-	Denton Wilde Sapte LLP
Ross Bryson	-	Mishcon de Reya
Andrew Chadwick	-	Rooks Rider Solicitors

Jonathan Deverill	-	Stikeman Elliott LLP
Jeanette Gregson	-	Davenport Lyons
Carol Kilgore	-	Curtis, Mallet-Prevost, Colt & Mosle LLP
Philip Lamb	-	Lewis Silkin LLP
Alex Melrose	-	Rosenblatt Solicitors
Laura Nuttall	-	McGrigors LLP
Chris Owen	-	Manches LLP
June Paddock	-	Fasken Martineau LLP
Donald Stewart*	-	Faegre & Benson LLP
Gary Thorpe	-	Clyde & Co LLP
Tim Ward	-	The Quoted Companies Alliance
Kate Jalbert	-	The Quoted Companies Alliance

QCA CORPORATE FINANCE ADVISORS

Tom Price (Chairman)*	-	Westhouse Securities
Azhic Basirov	-	Smith & Williamson Ltd
Richard Brown	-	Ambrian Partners Limited
Lesley Gregory	-	Memery Crystal LLP
John Cowie*/Mark Percy	-	Seymour Pierce Limited
Dalia Joseph*	-	Oriel Securities
Susan Walker	-	KPMG LLP
David Worlidge/ Simon Clements	-	John East & Partners
Ray Zimmerman	-	ZAI Corporate Finance Ltd
Tim Ward	-	The Quoted Companies Alliance
Kate Jalbert	-	The Quoted Companies Alliance

*Main Authors

APPENDIX B

THE QUOTED COMPANIES ALLIANCE (QCA)

A not-for-profit organisation funded by its membership, the QCA represents the interests of small and mid-cap quoted companies, their advisors and investors. It was founded in 1992, originally known as CISCO.

The QCA is governed by an elected Executive Committee, and undertakes its work through a number of highly focussed, multi-disciplinary committees and working groups of members who concentrate on specific areas of concern, in particular:

- taxation
- legislation affecting small and mid-cap quoted companies
- corporate governance
- employee share schemes
- trading, settlement and custody of shares
- structure and regulation of stock markets for small and mid-cap quoted companies; Financial Services Authority (FSA) consultations
- political liaison – briefing and influencing Westminster and Whitehall, the City and Brussels
- accounting standards proposals from various standard-setters

The QCA is a founder member of European**Issuers**, which represents quoted companies in fourteen European countries.

QCA's Aims and Objectives

The QCA works for small and mid-cap quoted companies in the United Kingdom and Europe to promote and maintain vibrant, healthy and liquid capital markets. Its principal objectives are:

Lobbying the Government, Brussels and other regulators to reduce the costing and time consuming burden of regulation, which falls disproportionately on smaller quoted companies

Promoting the smaller quoted company sector and taking steps to increase investor interest and improve shareholder liquidity for companies in it.

Educating companies in the sector about best practice in areas such as corporate governance and investor relations.

Providing a forum for small and mid-cap quoted company directors to network and discuss solutions to topical issues with their peer group, sector professionals and influential City figures.

Small and mid-cap quoted companies' contribute considerably to the UK economy:

- There are approximately 2,000 small and mid-cap quoted companies
- They represent around 85% of all quoted companies in the UK
- They employ approximately 1 million people, representing around 4% of total private sector employment
- Every 5% growth in the small and mid-cap quoted company sector could reduce UK unemployment by a further 50,000
- They generate:
    - corporation tax payable of £560 million per annum
    - income tax paid of £3 billion per annum
    - social security paid (employers' NIC) of £3 billion per annum
    - employees' national insurance contribution paid of £2 billion per annum

The tax figures exclude business rates, VAT and other indirect taxes.

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RESIDENTIAL LANDLORDS ASSOCIATION INITIAL RESPONSE TO H M TREASURY CONSULTATION PAPER : A NEW APPROACH TO FINANCIAL REGULATION

About the Residential Landlords Association (RLA)

1. The RLA is the voice of the residential landlord representing around 15,000 members. We are a direct membership organisation. The RLA represents landlords who manage properties in all subsectors of the private rented sector (PRS). Our members also include some agents. Our members rent out their properties to benefit customers, as well as tenants who are working people, families, young professionals and students, amongst others. We are a national landlords organisation operating throughout England and Wales.

Introduction

2. The RLA represents landlords who are very often dependant upon loan finance to purchase properties and carry out improvements and for working capital. These include buy to let (BtL) landlords and landlords who borrow from banks in the more traditional way, often by way of portfolio mortgages.

3. For ease of reference in this consultation we refer to BtL loans/mortgages but this is intended to cover the whole spectrum of loans which are made to landlords in the PRS for business purposes in connection with the purchase/improvement of their properties.

4. The RLA does not, of course, represent those directly involved in the financial services industry. Rather, we represent an important segment of the customers of the financial services sector. As mainly small but also medium sized businesses our members access to forms of external finance other than loans is somewhat constrained. The availability of credit is key and therefore the regulatory structure as it affects the provision of finance and credit is a key issue for our members. We are therefore responding to this consultation and answering the questions from the perspective of how we deal with these proposed reforms will impact on landlords as users of relevant financial products; rather than providers.

Housing Provision in the UK

5. The RLA believes that the fundamental problem with the housing market in the UK is that there are significant supply side problems due to a major shortage of housing with no real prospects of this improving, in the foreseeable future.

6. All predictions are that the overall population of the UK will increase to around 70 million. At the same time household size is shrinking. More and more households are being formed. The elderly are also living longer.

7. The last Government fixed a target to significantly increase the number of available units of residential accommodation by 2020 by building an additional 250,000 units per annum. There are absolutely no realistic chances of this being achieved unless there were to be a massive turnaround in the economy and house building policies.

8. Nevertheless, we have a fundamental problem of an imbalance of supply and demand. In macro economic terms this causes major problems because of the cycles of boom and bust in the housing market which are experienced. These inevitably trigger a wider recession as happened at the end of the 1980s and more recently the Great Recession which we are still living through.

The Private Rented Sector (PRS) and its importance as part of housing provision

9. The PRS now represents some 14% of overall housing provision in the United Kingdom (source CLG English Housing Survey). This percentage has increased from under 10% at the time of the passing of the Housing Act 1988. The introduction of market rents for new lettings coupled with the ability to rent under assured shorthold tenancies has led to a rapid expansion of the sector. Some commentators estimated that it could grow to 20% of overall housing provision by 2020. Certainly this could well happen if current trends continue. The owner/occupied sector stands at some 68% and the social sector at around 18%. The latter has contracted; not least due to purchases under the Right to Buy Legislation. Likewise, we have seen a reversal in the growth of owner/occupation.

10. If, as seems likely mortgage demand/lending to the owner/occupier sector remains constrained and the current economic situation continues for some time, this, coupled with the lack of additional funding for the social sector, means that, in our view, the PRS is going to have to become a major housing provider. This is against the background which we explained in the previous section. To enable this to occur mortgage funding for the PRS it vital. Local authorities are increasingly looking to the PRS to provide the required accommodation.

11. At the present time the mortgage market for the PRS is constrained. There are now only some 260 odd BtL mortgage products available (source Northern Rock) as against 2000 to 3000 at the height of the housing boom. Traditional high street banks have reined in their lending to the PRS.

12. The PRS is not a separate asset class. PRS properties and owner/occupier properties are interchangeable. The PRS competes with the owner/occupier sector for properties and vice versa. There is therefore usually a common pricing structure for sales and purchases in and between both sectors.

RLA concerns

13. First and foremost our concern is that the Government and the FSA seem to be embarking on a policy, the effect of which, intentionally or otherwise, is that the demand side will be dampened by constraining the availability of mortgage finance for consumers by potentially heavy handed regulation. Inevitably, this will reduce house prices. This will have knock on consequences for the PRS because of the close relationship between the PRS and the owner/occupied sector regarding prices/valuations to which we have already referred to in the previous paragraph.

14. In the RLA's opinion this is tinkering with the problem. It is dealing with a symptom and not providing a cure to the underlying disease, which we have already pointed out, is the dire shortage of housing accommodation as population expands and household sizes decrease. Without getting this balance right we are simply stoking up problems for the future, whatever the nature of the regulatory regime. We believe, therefore, that the consequences for the PRS are serious because if macro economic policies are implemented to restrict lending unless there is a balanced and proportionate approach to lending policies. This is because they are addressing the symptoms and not the disease.

15. Undoubtedly, in the recent boom prior to the credit crunch there were some excesses. For example in terms of mortgage lending Northern Rock's policy of lending on the basis of 125% of the value of the property was clearly inappropriate. Some earnings multiples became too high. What we caution against, however, is going to the opposite extreme which appears to be the results of the kind of policies which could result from these proposals. Even when lending conditions improve there will still be severe constraints on borrowing as a result of regulatory intervention. This will restrict the new entrants, the first time buyers, to the owner/occupied market. It will make it harder for existing home owners to buy a new property.

16. From the perspective of the PRS landlord the RLA is perturbed that such measures will adversely impact upon the value of existing properties driving them down by unnecessary and disproportionate constraints on lending. Because of the inter relationship with property values as between the PRS and the owner/occupied sector this will impact on collateral values. In turn it will make it harder for PRS landlords who rely on such collateral values to raise funding to help expand their property portfolios. Dr. Julie Rugg's independent review of the PRS for the last Government showed that overall the PRS has a low gearing at around 50% so that this is a valuable source of collateral to fund new acquisitions etc. If implemented proposals could damage the value of this vital element of collateral security.

17. We are also most concerned at the adverse impact on loan to value ratios. Already these are under close scrutiny from various lenders. By driving down property values through constraints on lending, on top of existing market constraints, we are in danger of starting a downward spiral. Nationwide figures show in the last quarter house prices fell over the quarter. Thus disproportionate and unnecessary lending policies could well exacerbate this trend preventing any recovery to the housing market. There is a great danger of over reacting. There needs to be a correction no doubt but this will be provided over time by market forces and adding regulatory restraints could simply make matters worse, as we explain further below.

18. Whilst it is appreciated that the current situation is being masked to some extent by the current low interest rates, at the present time repossessions for arrears are relatively low having regard to the impacts of the credit crunch and the downturn in the housing market. In our view what may happen as a matter of speculation as and when interest rates rise does not justify the kind of regulatory restraints being proposed. Experience from lenders such as Paragon that there is less problem with arrears in the BtL market as opposed to the owner/occupier market in any case.

Regulatory Effectiveness

19. We have to say that landlords, in our experience, are generally sceptical about the effectiveness ore regulations. Clearly, the existing tri-partite system was ineffective when it came to dealing with the boom which led up to the “credit crunch”. There was a notable individual failing when it came to dealing with Northern Rock. Some economists would, however, say that a major cause of the boom was the wish on the part of the UK and US authorities to provide cheap money to create a credit boom so as to induce a “feel good” factor on the part of their respective electorates. This occurred despite the Monetary Policy Committee being responsible for monetary policy issues. Perhaps the problem was that the remit of that Committee was virtually confined to and the target of inflation being limited to 2% per annum.

20. We appreciate that Regulators have dusted themselves down and now promise us that the same thing will not happen again. Time will tell. The power of UK regulators is to a certain extent limited because of the globalisation of finance and the rapid flow of capital across the world. Indeed, can any regulatory system withstand these kind of market forces. There is also a serious danger that the advantages of a new regulatory system, even if it were to be effective, could be outweighed by disadvantages, which is the main concern of the RLA so far as the proposed reforms are concerned.

Regulatory overkill

21. Having been found wanting on their watch, there is a grave danger that under the new dispensation regulators will want to portray a macho image

to show the world that we are in a whole new era. In the same way that perhaps the previous system was too light touch the grave danger is that as so often is the case the pendulum will swing too far in the opposite direction. “Moderation in all things” is a good maxim to operate by. The serious risk is that regulatory interventions will hobble the housing market in particular at a time when it is already at an extremely low ebb. History shows that average house prices should be at around 4 times average earnings. Currently, they stand nearer 5 times than 4 times. There are indications from recent surveys that house prices are still falling. Average house prices would have to bottom out at around £140,000 as against the current £164,000 approximately. As we have already pointed out, since housing in the PRS is, in effect, in the same asset class as in the owner/occupier sector, this has significant consequences already for the PRS because of the reduction in value/collateral. Market forces are already at work restoring the equilibrium.

22. The RLA’s concern is that excessive regulatory interventions will exacerbate an already difficult situation. The market is finding its own level. Such interventions would now be counter cyclical. Excessive regulation would therefore further dampen demand unnecessarily driving down house prices still further when there needs to be a recovery in valuations. Not only do we have the dearth of available capital by way of new loans but the Council of Mortgage Lenders has calculated that had the proposed affordability criteria suggested by the FSA been in force 4 million less mortgages would have been approved over the last four years. Some would argue at a time of high demand that this might be no bad thing, although the RLA would not necessarily agree with that view point. Surely, however, everyone should agree that to impose that additional restriction in “normal times”, let alone the current situation, will both deprive people of homes they want to buy or rent but also unnecessarily drive down prices and destroy capital values. We have to bear in mind that the proposals are intended to apply all the time and are part of any proposed macro prudential tool kit.

23. The RLA most certainly does not want to encourage bad lending practices (e.g. Northern Rock lending at 125% of value) but we do strongly oppose measures which will unnecessarily depress values and restrict the availability of capital. As we have already pointed out, it is essential that landlords are able to borrow to finance purchases to help expand the PRS so as to meet the demand for this accommodation, to which we have already referred above. We, therefore, believe that it is very important when setting high level policy to ensure that the impact of regulation is not such as to “throw the baby out with the bath water”. Regulators must keep at the forefront of their decision making the need to allow the housing market, including the PRS, to function so as to provide accommodation for everyone in Society. If people cannot access the owner/occupier market and are shut out from social housing then, as we have already pointed out, they have no option but to look to the PRS. PRS needs to be expanded but to do this the PRS needs access to credit. However, what happens in the owner/occupier sector inevitably impacts on the PRS because of the close

inter relationship since both owner/occupiers and landlords in the PRS are dependant on the same stock. Against this background we look at the individual questions where relevant to the PRS.

Costs

24. As is unfortunately so often the case the consultation paper talks about costs falling on financial product providers. This is wrong. These costs one way and another ultimately fall on the users and our members as a major segment of users of lending services in particular are those who have to pay so as to enable the providers to comply with regulatory requirements. This is a significant on cost. It needs to be recognised. Otherwise it is the same myth that the Government pays for everything. It does not. It is the tax payer by and large who does so. In turn it passes on to tenants.

25. Since the onset of the credit crunch our members have constantly complained to us about steps taken by lenders to increase their margins. Loans have been reconfigured so that they reflect LIBOR rather than bank base rate. Percentage margins have increased. Whilst official rates of interest may stand at around 0.5% actual cost of borrowing is far higher. The very cheapest buy to let product is currently at around 5% and often significantly more. Administration fees and initial fees for obtaining mortgage advances are now imposed or are significantly higher than they were before. There has been a seismic shift in borrowing costs in the credit crunch and, in turn, this has to be passed on by landlords in the PRS to their customers, their tenants.

26. The Government now complains loudly about amounts having to be paid out by way of housing benefit. DWP predictions are that this will rise to £20billion per annum. Unfortunately, the cost of housing (especially in London, the South East and high value areas) are reflected in the level of rents but at the same time the cost of borrowing drives up rental levels, which in turn feeds through to local housing allowance (LHA)/housing benefits (HB) rates. As and when interest rates start to rise again, and they can only go one way, clearly there will be a significant increase in costs which will then fall on PRS customers.

Question 1

27. The RLA strongly believes that matters other than financial stability should be dealt with by way of secondary objectives. Simply to "have regard" to them (i.e. just consider them) is insufficient. Regulation must not be carried out for its own sake. The danger is regulatory overkill. Having failed so spectacularly once every regulator going forward is going to want to cover his/her back to avoid a repeat on their watch. In the meantime, millions of people are going to be adversely affected whether by being shut out from owner/occupation or, in the case of landlords, being prevented from expanding their portfolios to provide the additional accommodation which we need to meet the needs of an expanding

population in smaller households, unless regulation is applied in a correct way.

28. Experience has shown that in previous recessions certainly since the Second World War the property market has played a key part. This has involved a number of factors namely (1) fuelling a consumer boom because of the increasing equity in owner/occupied properties (2) speculative buying and selling (3) speculative building/property development. A new phenomenon entered into in the equation the last time round namely "the buy to let mortgage". Undoubtedly, new landlords came into the PRS in the belief that they could profit from rising capital values. There was a speculative element for a time in that some properties were left vacant in the belief that they would appreciate. Whatever the criticisms in the RLA's view the end result has been major new investment in the PRS. The PRS helped to provide finance by way of off plan purchases to enable new properties to be built. Unfortunately, in our view, the planning system skewed these developments particularly because of the perceived need for high density and also the fact that flats rather than houses meant that the targets were met. This is really a basic fault of the planning system.

29. Lending to the PRS should be separated out and treated separately from this kind of lending which can become "frothy" in boom times. It is not speculative lending. Rather, it is lending to landlords to enable them to purchase properties for their portfolios, which in turn supply the vital housing need which is the function of PRS. The PRS is therefore a significant customer for bank lending collectively and decisions regarding financial stability, especially in relation to lending, will have a profound effect on the health and development of the PRS. As already indicated above, the PRS will play an increasingly important role in overall housing provision so funding is crucial to the supply of housing.

Question 2

30. The key consideration, in the RLA's view, is the consequences/impact of decision making on not just the economy but Society overall. Whether we like it or not the economy needs to grow and economists have indicated that due to the expanding population the economy needs to grow each year by around 1.5% effectively just to stand still. Growth is fundamental to any economic well being. It also has to grow to meet rising aspirations. This is our fundamental concern regarding the potential for over regulation to give rise to negative consequences, stifling growth, and retarding economic well being and Society. Against this background we consider that the secondary factors should include the following:-

(i) The consequences for economic growth
(ii) Impact on different sectors of the economy
(iii) The consequences for social well being
(iv) The consequences for the financial sector
(v) Impact on housing provision

(vi) Levels of lending to businesses and individuals
(vii) Need for innovative financial products (which do not give rise to undue detriment to financial stability)
(viii) Competition

This is in addition to the existing factor in Section 2(2) and (3) of FSMA 2000.

31. The consultation paper specifically mentions a general public interest test. Financial stability must not be an objective for its own sake. It cannot operate in isolation. Its purpose must be to help develop and improve Society generally and the economy in particular. There therefore in our view needs to be a general requirement to have regard to the overall public interest when it comes to considering secondary objectives and balancing them against the primary objective (to which we made reference in the reply to the next question).

32. It will be noted that we have made specific reference to the housing provision. This is a major element of the social and economic fabric of the country. We have some 21 million dwellings in England housing 48 million people (plus all the properties elsewhere in the United Kingdom). This gives some indication of the scale and importance of housing provision overall. Most people who own a property do so as their main asset so this makes it even more significant.

Question 3

33. The RLA strongly believes that this should be addressed by way of secondary factors. They should be secondary statutory objectives which the FPC must take into account and balance against the primary objective of financial stability. We would go so far as to say that occasion may arise where collectively these secondary factors may be of sufficient weight that as a matter of judgment they should outweigh what could be argued as being a primary matter to promote financial stability. To give an extreme example if it is clear that the use of macro prudential tools would lead to major public disorder (examples of which have occurred elsewhere in the world) then one would have to think long and hard before using such a tool to enhance the financial stability. We have deliberately given this extreme example to make a point but on occasion a view may have to be taken that things have to be done to promote growth to get the economy back on to its feet even at a risk of detriment to overall financial stability. Two examples may be given. Firstly, some of us would argue that the long term consequences of quantitive easing may be major inflation but the risk has had to be taken. Secondly, in a depression action may need to be taken to stimulate economy and risks may need to be taken with financial stability to do this. It is a matter of judgment.

Question 4

34. The RLA would agree that the PRA must have regard to the primary objectives of the other regulatory bodies. Perhaps a better idea might be to

have a common set of objectives applicable to any regulatory body (both primary and secondary) but then with additional secondary objectives as appropriate for individual bodies. In some instances some of this common set might need to be deleted or modified to meet the particular circumstances of a regulatory body. Surely, if we are going to have an effective new system then everyone charged with implementing this system from the Treasury downwards need to be "singing from the same hymn sheet" and acting according to a common set of objectives, adjusted where appropriate to meet the duties of individual regulators. It would be a much clearer framework. It will also be more effective than the "have regard" formulation which we have already criticised above.

35. We agree that the current regulatory framework within Section 2 of FSMA needs to be retained (subject to any appropriate modifications). This provides a set of objectives as already mentioned.

36. We have already pointed out above that competitiveness is an important factor which must be an objective of any new system. Some have, in our view, rightly taken the view that their needs to be new entrants/new products to the system to provide additional competition. One of our concerns is that any new regulatory regime may stifle/slow down any new entrants. For example, in the "buy to let" sector many firms have disengaged from this sector but as times improve may want to return. Whilst they need to be vetted for suitability we do not consider it would be in anyone's interest for this to be an unduly long process. In particular we are concerned to hear of the supposed delays that appear to be happening with regard to Tescos entering the market to provide financial services.

37. As already mentioned above, we consider that there needs to be a general public interest requirement. We have referred to this in the reply to Question 2.

<u>Question 5</u>

38. We do not believe that this is the correct model. We are at a loss to understand why two separate authorities, the PRA and CPMA are needed. We believe that the distinction between the micro prudential regulatory matters on the one hand and business conduct on the other is artificial. It will give rise to all the old problems associated with the current regime. It will lead to unnecessary duplication. It seems to us that at the same time as the Coalition Government is rightly making a bonfire of many quangos it is seeking to create two new quangos which will compete with each other and duplicate work. We have already strongly made the point about the cost of all of this which is passed on to the end user for additional compliance costs. It is another recipe for a mess. If there are to be two authorities (to which we object) then clearly they should only need to deal with one. We do have to say that we find it rather strange that a Government that is seeking to cut down bureaucracy is wanting to introduce such a complex new system with duel authorities involved regulating overlapping aspects of the economy.

Question 6

39. Following on from our response to the previous question the RLA does not consider that the proposals are sufficient to enable PRA to take a more risk based, judgment focused approach to supervision. If you look at the functions listed in paragraph 3.20 there is a clear overlap between micro level prudential regulation on the one hand and conduct regulation on the other in the case of those firms which are subject to both. The manner in which they conduct their businesses inevitably impacts on micro-prudential issues. Conduct is clearly relevant to authorisation. We are also going to end up with two different sets of rules. Again, we would point out the inevitable consequential costs of this overlap/duplication falls on the users of financial products. We are also concerned about the potential for "turf wars" between different regulators and all the problems that can result from these. The list of recent regulatory failures is long e.g. Equitable Life, Northern Rock etc etc. None of this inspires us with any confidence that anything would be better and we believe that there is the clear potential for further problems because of the artificial dichotomy between conduct regulation on the one hand and micro prudential on the other. We can do not better than point out paragraph 4.55 of this consultation document relating to the relationship between the FSA and the OFT. "This division between two regulatory bodies can lead to confusion, potentially results in outcomes of sub-optimal for consumers and firms". This will be the case when you have split functions between the PRA and the CPMA.

Question 7

40. Yes, we consider that the same safeguards are referred to in the consultation paper should remain. It is very important that draft rules are subject to proper scrutiny. Experience shows that if this does not happen you end up in a less than satisfactory situation.

Question 8

41. We do not consider that the FSMA safeguards need to be altered.

Question 9

42. These are not really matters for us to comment on.

Question 10

43. We have already made the suggestion that there should be a common set of primary and secondary objectives for all regulatory bodies. Clearly, they have to work in unison.

44. We consider that the principles set out in Section 2 of FSMA 2000 should be retained as stated above with the additions which we have already referred to earlier.

45. We believe that it is vital that requirements have regard to adverse effects and innovation or competitiveness should be retained, for the reasons already explained.

46. We consider that there must be broader public interest considerations and we have already elaborated on these above in relation to the PRA and the same should apply to the CPMA.

QUESTIONS 11 TO 21

47. We do not think we are in a position to comment constructively on any of these matters.

QUESTION 22

48. Time and time again when we comment on impact assessments we remark on their inadequacy. In this instance it is noted that comments are sought from the industry. This makes our fundamental point that no proper consideration is given to the wider impacts especially in relation to the users of financial products. Furthermore, there is the resulting consequences both in relation to cost of regulation and the wider consequences for the economy in society.

49. This consultation paper indicates a fundamental shift in regulation and undoubtedly a thorough review is needed to learn lessons from the credit crunch. As we have already pointed out, however, the real risk is that the pendulum will swing too far in the opposite direction. We therefore need a full appraisal of the consequences of what is being proposed particularly in "normal times" as opposed to a crisis. For example if, as the CML and others have calculated, 4 million people are excluded from owner/occupation as a result of these measures what is the result of this? Their hopes and aspirations are dashed but they still have to live somewhere. What is the social impact of them living on with their parents, perhaps in overcrowded conditions. Will they be able to rent? Importantly, from the perspective of our members will our members be able to meet the demand for accommodation for them. Will the lending be there to enable them to do so? It certainly is not at present. Can the tax payer afford to pay for the additional social housing which would be needed. Almost certainly not.

50. The point has already been made that there is a great danger in this becoming over regulation. Yes, we have to be prudent but if we have overkill there is no economic growth. Reduced tax revenues result. There is the need for extra public borrowing to meet the shortfall and so on. The vital thing is that these issues are look at in the round. Yes, it does involve taking risks and exercising judgment. Quite rightly the current health and

safety culture is criticised. We are in grave danger of translating this health and safety culture into financial products and the wider economy. At the same time we have to get the balance right and be careful to avoid some of the notable excesses of the recent past. This is why it is vital to have a proper impact assessment regarding new scenarios which may occur. Can someone do a calculation as to what are the consequences if 4 million people over 4 years who would otherwise have obtained mortgages are excluded. What about the impact on the private rented sector if capital to fund purchases/improvements of properties to expand the sector to meet the consequent demand for housing is not forthcoming. What are the consequences for social and labour mobility if people cannot move because no one can buy their house because they cannot get a mortgage? Newspapers commentators have said that the changes implicit in this paper effectively end the so called "right to a mortgage" which has now existed for some 25 to 35 years. These proposals could reverse that. The consequences therefore need to be looked at very carefully, in our view.

Other Matters

51. There are certain other matters of importance which are not addressed in the consultation which, in our opinion need consideration as follows:-

(a) Scope of regulation

Under the previous Government the Treasury consulted on the suggestion of extending regulation to the "buy to let" mortgage market. The RLA opposed this suggestion and the last Government deferred the idea for further consideration. Our view remains the same. We are opposed to any extension of such regulation. The consultation paper talks in terms of "consumers" and the "retail market". We therefore believe that buy to let mortgages which are a product of a business, not consumers, should be left outside the scope of regulation as such in respect of good conduct and the like. In any case it is very difficult to frame an appropriate and proportionate regulatory regime. Landlords are of varying experience. In any case, there has to be emphasis on personal responsibility. If someone takes on the purchase of a buy to let property or property to rent out then they are going into business and have to act and be treated as such; not mollycoddled.

(b) No deposit taking institutions

The FSA has raised the issue of regulation of non deposit taking institutions in its parallel consultation paper. We are pleased to note that there is no proposal to bring them within the scope of regulation. We support this viewpoint. This interlinks with the previous point. These are, of course, a vital source of supply of funding to the private rented sector. Clearly, there has to be a separate suitable level of macro-prudential regulation across the financial sector as a whole and we do not see the need to regulate these firms in the same way as others.

(c) Impact of Taxation

When it comes to regulatory imposition, it is important that account is also taken in taxation issues. The normal accepted rate of net return by way of rents for the PRS is of the order of 3% to 4% per annum. Currently, according to IPD it is running at around 2.7%. The PRS has traditionally been dependent on capital growth as well as income. The kind of macro prudential tool which could be suggested is amortisation with capital repayments alongside interest repayments. We have already commented on this issue in answer to the FSA consultation in relation to interest only mortgages. However, the taxation system makes repayment impossible on the margins available from a well run property. Tax relief is only given on interest repayments; not capital repayments. Having to repay capital alongside interest would therefore destroy the yield. It would lead to skimping on repairs and maintenance as well as reduction in management standards. This has led to so many problems with the PRS in the past. At long last in its consultation on investment in the PRS the Treasury recognised publically the first time the disastrous impacts the Rent Acts. Fortunately from 1988 onwards are not subject to them but we are still suffering a historic legacy from that legislation. Landlords are having to subsidise their tenants. This led to a much lower standard of repair for which the PRS has been criticised but, of course, in life "you only get what you pay for". If the rental income is not there to service the repairs/maintenance or management then they do not happen. Thus, the combination of the taxation regime and the low yields mean that this kind of macro-prudential took could prove disastrous for the PRS if it were to be implemented.

(d) Market Forces

Regulatory reform is all very well and undoubtedly some is needed. Recognition, however, has to be given to the realities of the market, as well as human behaviour. If someone gets on to something that they perceive to be a good thing then as soon as it is known everybody else wants to jump on the band wagon. It is the "Lemming" effect. With the best will in the world it is very difficult to stop Lemmings jumping over a cliff. Markets are of course not always rational but they do set up forces which it is very difficult to resist at times. In any case almost always markets will invariably correct themselves and put right the wrongs and excesses which have occurred. Realistically there is no possibility of stopping boom and bust cycles. They have been a feature of human history and there is no reason to believe that however diligent regulators may think they are that they can in reality do very much about it. At the time what is perhaps needed is an injection of commonsense to try to stop some of the excesses.

(e) Current lack of available credit

At the risk of repeating ourselves, we have to again emphasise the dire consequences and the current lack of availability of credit. Banks and other lending institutions are under pressure to repair their balance sheets and to retain more capital. In the light of BASEL III, this trend will accelerate. This is an illustration of the kind of regulatory consequence which ensues. Generally, commentators are agreed that inevitably there will be less capital for lending. At the moment the Coalition Government is rightly telling the Banks to lend more but at the same time demanding that Banks strengthen their balance sheets. The two cannot go hand in hand.

(f) Property Lending

The RLA is very concerned at the recent suggestion by the Business Secretary that non property lending was a good thing and therefore by implication property lending was a bad thing. We have already commented above on the importance of the PRS as a housing provider and that it should not be classified in the same way as more speculative ventures. Whilst there may be some problems on the edges at the end of the day it is solid lending to a vital service provider. Accommodation is essential as a shelter and a place where the family lives. We are talking about funding one of the fundamentals; one of the necessities of life. We strongly believe that a distinction must be drawn between lending for this purpose to the PRS and perhaps other forms of property lending. This should be taken into account in the formulation of any regulatory regime which may result.

(g) Potential macro-prudential tools

Whilst no question has been asked about this Box 2C does summarise potential macro-prudential tools which could be used by the authorities.

The overall problem with this approach, as pointed out in the earlier paragraph, is how far these can resist market forces. As the consultation paper itself rightly points out it can lead to market distortions, particularly any imposed over any period of time. For example, in the 1960s and 70s because of increasing affluence there was a greater demand for owner occupation. The PRS was suffering under the constraints of the Rent Acts and as soon as landlords obtained vacant possession they would sell the property to owner occupation rather than letting it out again. The net result was that we now have a smaller private rented sector than in many other countries. We have a perhaps excessive emphasis on owner/occupation. The recent Decent Homes Enquiry conducted by CLG Select Committee pointed up the problem of poor owner/occupiers. There is now a major worry that they are not sufficiently well off to be able to repair and maintain their homes. Over time this is going to lead to an overall significant deterioration in housing stock. They have been forced into owner/occupation because there have been no realistic alternatives even though they cannot really afford it. Perhaps the better alternative would be a vibrant PRS where landlords provide and service the capital and carry out repairs and maintenance. Tenants then pay their rent in the knowledge that they do not need to meet further liability for the upkeep of the property. This is the kind of distortion that policy makers need to have in mind over a period of time. It came about in a different context but this could clearly happen again. We always have to be aware of the law of unintended consequences in these things.

The relaxation of restrictions on restrictions on credit as well as access to wholesale markets to supplement deposits meant that from the 1970s onwards the owner/occupier market expanded to meet rising demand, due to improved levels of wealth in society. Unfortunately, at the time, there was no counterveiling buy to let market whereby buy to let mortgages were made available until subsequent to the implementation of the Housing Act 1988. The buy to let market seems perhaps to be blamed partly in some way for the credit crunch. In fact, this is a wholly wrong view because the buy to let market was functioning to allow landlords to obtain finance. This has led to the expansion of the private rented sector from around 10% of the housing provision at the time of the passing of the Housing Act 1988 to the 14% approximately where it stands now. In the meantime, the owner/occupier market has contracted a little. Again, this reiterates our serious concerns that any stigmatisation of property lending particularly to the PRS will be counter productive so far as overall housing provision is concerned. We need the PRS to invest to help acquire new units either by purchasing them directly or by purchasing "second hand properties" from those who in turn buy new properties. In this way overall housing provision can be expanded.

As regards specific suggested macro-prudential tools we do have particular concerns in relation to the suggestion of "variable risk waits". Clearly, mortgage lending and mortgage lending to the PRS could be dealt with in this way and as we understand it the FSA has imposed requirements of this kind in the case of specific institutions e.g. Clydesdale Bank. As already indicated this can generate the kind of distortion which we are talking about. It makes the cost of lending greater for a specific sector which in turn has to be passed on to its consumers i.e. in the case of the PRS tenants who then end up paying higher rents. This puts up the cost of living and has a consequent need for increased housing benefits for those on low incomes.

Collateral requirements can also give rise to distortions and, very importantly, can unnecessarily restrict access to capital with the results which we have talked about elsewhere in this response. The same consequences can result from quantative restrictions which we have emphasised in this response, as well.

Conclusion

52. The RLA does acknowledge the need for a careful review of how regulation operates. Clearly the tri partite system set up by the last Government failed miserably to deal with the credit crunch. We strongly believe that there is a danger of this error being repeated. Ironically the

new system is a tri partite system. We believe that a common set of principles must be adopted and the PRA and the CPMA should be one. Our major concern, however, is that regulation becomes too stringent because of a safety first culture. It becomes an end in itself; rather than looking carefully at what is necessary in the public interest to ensure a growing and vibrant economy and a Society which is functioning and deals with itself. Getting this wrong could have long term serious adverse consequences, particularly for the already strained housing market. One has to bear in mind that if one uses for example macro-prudential tools in various ways that the collective effect when taken in combination can mean that the resulting adverse consequences are far worse than the original problem. This is what is in danger of happening here.

October 2010

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Financial Regulation Strategy
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13 October 2010

Dear Sirs

Re: Consultation - a new approach to financial regulation: judgment, focus and stability

The Retail Motor Industry Federation (RMI) represents the interests of retail businesses within the automotive industry, one of the largest industrial sectors in the UK, employing 570,000 individuals in 70,000 businesses. The retail motor industry sector alone has a turnover of £14billion. The RMI has 8,000 members representing the interest of new and used vehicle dealers, vehicle repairers, motorcycle retailers, petrol forecourts and vehicle auction houses.

The RMI in principle welcomes the Government's review of financial regulations and the opportunity to comment. We believe the splitting of Financial Services Authority (FSA) responsibility between the new Prudential Regulation Authority (PRA) and Consumer Protection and Markets Authority (CPMA) will improve and better focus financial regulation. The following is in answer to your questions:

CONSULTATION QUESTIONS

Consumer Protection and Markets Authority (CPMA) – Questions 10-14

The RMI broadly agrees that the FSA's principles laid down in section 2 of the Financial Services and Markets Act 2000 should remain under the new CPMA. We are particularly concerned that the regulatory burden for small firms and firms carrying out low levels of regulated activity should be proportionate. We have had concerns since regulation of insurance selling fell under the FSA in 2005, that the cost and regulatory burden for firms has been too great compared to the levels of insurance sold. Further, the cost and regulatory burden has lead to a number of motor retailers ceasing to provide insurance products to their customers, and has increased the development of non-regulated products such as guarantees instead of warranties. This has not benefited consumers by restricting choice and making it more difficult for consumers to source insurance products easily.

Therefore, the principle of proportionate burden needs to remain. However the CPMA needs to insure that its regulatory framework and overseeing powers are truly proportionate and that the cost of being regulated is not too great, both in terms of fee structure and administration.

We will be very interested in the upcoming consultation looking at Consumer Credit Regulation. We feel the current framework for supervising consumer credit selling balances well the need to regulate, at the same time keeping the administration requirements of regulated firms to a minimum. We would like to see this remain and for the new CPMA to follow this example when regulating insurance.

If you require further information please contact us.

Yours sincerely

Louise Wallis
Head of Business Development

Tel: 01788 538336

RESPONSE TO "A NEW APPROACH TO FINANCIAL REGULATION"

by Sir Adam Ridley

I am writing this note in a personal capacity, but in so doing am drawing on extensive experience in financial regulation and legislation stretching back over some 30 years both inside government and out. In particular I have been directly involved in the Financial Services Act (FSA 86) of 1986 when I was a Special Adviser in the Treasury and other departments and an Executive Director of Hambros Bank; with a wide range of regulatory problems and reforms in the Lloyd's (insurance) marketplace in the 1990s; with the Financial Services & Market Act (FSMA) of 2001 when I was Director-General of the London Investment Banking Association (LIBA); and as a Director/Council Member of a number of substantial organisations in the financial sector, including the Council of Lloyd's (1997-99); and, at this time, the Association of Lloyd's Members (ALM), Morgan Stanley Bank International and the Lloyd's Members' agency and Hampden Agencies Limited.

In this note I have concentrated on five general issues, rather than responding directly to the 22 point questionnaire in the Consultative Document. I would be delighted to enlarge on any point, and to expand on the research, experience and reasoning which lie behind them.

FIVE GENERAL CONCERNS

Consultation

The hurried preparation and introduction of the FSA 86 and the rather experimental, haphazard and disjointed consultation with market practitioners associated with it, demonstrated very clearly the great importance of thorough and considered consultation with the markets. When in 1997 the incoming government initiated an even bigger change when putting forward what was to become the FSMA, the timetable was, as today, a very hectic one. The Bill submitted to, and adopted by, the House of Commons was, unsurprisingly, not very good. The consultation about it with market participants was desultory and ineffective; and the House of Commons unresponsive to suggested changes – unsurprisingly so, given the Government's sense of urgency and enormous majority. However the debate on the Bill in the House of Lords permitted sustained and very intense and professional consultation with market participants and market professionals such as accountants and lawyers. This led to many important changes and amendments. A large number were adopted by officials as a result of this consultative process, rather than being forced on the authorities, one way or another, by their Lordships. The result was both a dramatically better Bill; and the very important and **widely accepted conclusion that systematic consultation on such specialised and sensible matter was invaluable and needed to become the norm.**

A crucial provision of FSMA was, happily, that the authorities should consult market participants comprehensively, not only about changes in regulatory legislation, but also about statutory instruments, rules, guidance and so on deriving from the FSMA. The FSA's norm of a three month consultation period, subject of course to reasonable exceptions, was adopted and followed consistently to this day. It has been an extremely important provision – time and again officials and market participants have been able in an unmelodramatic and professional way to exchange views about how to improve rules, guidance and – far from insignificant – the enforcement process. In addition the existence of this provision and the benefits it has brought have been important in supporting the pressure on the EU, IOSCO and other such bodies to adopt similar procedures. To remove such provisions now could well be harmful to continuing efforts to promote transparency and consultation in such bodies.

On the basis of this experience, as well as of the general principles of transparency in democratic procedure, the case for continuing (and providing in the legislation) for full, careful and unhurried consultation at all stages in the enactment, implementation and longer run operation of the new regulatory framework is fundamental.

ACCOUNTABILITY

When contemplating the new regulatory structure proposed by the previous administration post 1997, which involved reshaping almost all the established self regulatory and public regulatory apparatus, there was a clear need in principle for **two kinds of accountability**: to Parliament; and to market participants of all kinds.

Accountability to Parliament

At the time, some observers hoped that provision would be made for a special standing select committee on financial regulation – perhaps a joint committee of both Houses of Parliament – with the task of overseeing the operation of the new FSMA and FSA. In the event, no such body was created. In the last decade, the activities of the FSA were only one of a number of many important items on the agenda of the Treasury Select Committee and occasionally other Parliamentary bodies. Parliament played little or no attention to the roles in financial regulation of the Treasury or the Bank of England.

It is not surprising that one of the lessons to be drawn from the crisis of 2007 is that Parliament was too distant from the regulatory process. In particular, neither the Houses of Commons or Lords nor any committee was keeping a sustained eye on the activities of the FSA, Bank of England (or the Treasury come to that in 2007) as the problems, pathological trends, and misjudgements mounted in 2007 and culminated in the crisis of September that year. One further and important result was that Parliament was slow and amateurish in its subsequent belated investigation of the crisis and the authorities' response to it. This was inevitable since it was "thrown in at the deep end" as the crisis broke.

The corollary of both the general argument and this recent historic experience is that proper Parliamentary oversight of the new regulatory machinery is essential. This means a body which on a regular basis examines developments in the prudential and market conduct areas throughout the financial sector, coupled with the closely associated issues of monetary policy. The kind of institution which both the proposed legislation and objective circumstances call for is more ambitious, endowed with more powers and resources, and calling for more independence than any standing Parliamentary committee of recent years.

Accountability to market participants

Accountability to market participants, both consumers and providers, is assured under the FSMA by the Practitioner Panels. These institutions have attracted little publicity. Even amongst market participants, surprisingly small numbers of people and institutions are aware of their existence, let alone appreciate their role. This is in no way to be interpreted as a measure of their effectiveness. The experience of LIBA in particular demonstrated that the wholesale markets panel was capable of being extremely effective, even if its members were often faced with almost impossible challenges arising from its unrealistic and hectic timetable, the difficulties faced by individuals in obtaining swift and authoritative briefing, and the very modest staff supporting its work.

While there is no reason for suggesting a slavish recreation of the panels in place today, there is a powerful case for establishing some such organisations in the new regime. New market participant panels borrowing, with obvious changes, from the constitution and procedures of the old, should be both more effective in engaging with the new regulatory institutions, and in communicating with the "constituencies" for whom they speak.

PRINCIPLES OF GOOD REGULATION

As para. 3.22 of the consultation paper notes, the FSA has a duty, which it has amplified and developed intelligently, to follow a series of important principles of good or better regulation. Underlying this duty is a chain or algorithm that starts with establishing material market failure (or a serious risk of such failure); consideration of regulatory (or self regulatory) measures which might mitigate such failures; the cost benefit assessment of the likely cost and impact of such measures; consultation of market participants on all the above; and, ideally, a repetition of this process from time to time to ensure a proper feedback process.

Such procedures are incontestably wise, indeed probably essential, in any healthy, evolving financial market place. It would be foolish and damaging not to sustain them procedures under the new regime. The commitment both to the goal of better regulation and to the procedural algorithm by which it is best attained should be incorporated in the new legislation.

A BROADER PUBLIC INTEREST CONSIDERATION TO WHICH THE NEW LEGISLATION SHOULD HAVE REGARD: STRENGTHENING COMPETITION

At the time of the enactment of the FSM Bill, a number of observers were concerned that the new apparatus paid insufficient attention to the importance of preserving or strengthening competition. (Competition in the classic industrial-economic sense is, of course, nothing to do with the much discussed "competitiveness of the London markets"). Unfortunately the FSMA did not make the preservation or the strengthening of competition an objective or side condition for the new FSA. It was not long before experience showed that this gap was important and that the absence of such an objective could create real problems. In particular, one important example arose when stock exchanges and post-trade institutions became the object of proposed mergers and takeovers (e.g. the Deutsche-Börse bid for the London Stock Exchange).

Contacts at that time with the FSA and other bodies (including the Treasury and the Bank of England) strongly indicated that there was no part of Whitehall or the FSA which believed it had much responsibility for preserving or strengthening competitive conditions in these crucial, systemic institutions. For various reasons, European Community policies and regulation did not provide a much better answer either (apart from anything else, systemic though such institutions may be, they are far too small to meet the arbitrary minimum size criteria set by the Directive to qualify for direct consideration by the Brussels Competition authorities). While the OFT and Competition Commission were in a position to interest themselves more directly in such proposals, their potential involvement was tightly constrained and did not promise the close and sustained involvement which wise decisions about such sensitive institutions would ideally receive.

These experiences and the prospect of further developments not only in relation to exchanges and post-trade institutions, combined with the certainty of yet more mergers and concentration in the international broker-dealing and banking sectors, point strongly to the need to give the new regulatory framework a clear and effective role in monitoring competitive developments and preserving plural markets and competition where possible and desirable. The likelihood of growing concentration in the most strategic and systemically important sectors is increased by the well known fact that stricter regulation creates ever greater barriers to new entrants and often discourages innovation. This is, of course, an international issue as markets become global – but that serves only to increase rather than reduce the importance of providing more effective institutions and, to safeguard competition and for attaching greater emphasis to increasing competitive conditions.

PAYING FOR REGULATION, AND THE AVOIDANCE OF CROSS-SUBSIDY BETWEEN UNRELATED SECTORS AND FIRMS

It is clear in principle that the components of the financial sector are numerous and heterogeneous, as are the industrial and individual consumers of its services. Paying for a new, rather expensive regulatory structure by imposing broad and rather indiscriminate levies on market participants therefore raises the vista of massive and unintended cross-subsidy which is *ipso facto* unjustifiable and damaging; and should therefore be avoided from the start by an explicit ban in the legislation. In the discussions over the FSMA, it was recognised, therefore, that levies to pay for the FSA's costs of administration and regulation, or to contribute to sectoral compensation schemes, should be confined to the relevant sectors, and cross-subsidy was formally ruled out [although there was some back-sliding from this commitment in recent years]. It would be unjust, unpopular, inefficient and a source of serious moral hazard (and political criticism in a crisis) if the new system were not to take a firm, uncompromising and unshakeable commitment against cross-subsidy in the levying of fees and the payment of compensation.

Such a commitment to avoid cross-subsidy in levies on and payments to market participants should be embodied in the legislation itself; made hard to modify or remove; and be protected by some kind of independent appeal process.

SIR ADAM RIDLEY
19 October 2010

Rolls-Royce

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11th October, 2010

From the office of the Chairman

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

Dear Chancellor,

I am writing as Chairman of Rolls-Royce Holdings PLC, a London Stock Exchange listed company and as a City practitioner of over 40 years, in connection with the consultation process as to whether the UK Listing Authority (UKLA) should form part of the new Consumer Protection and Markets Agency wholesale markets division (CPMA) or part of the Financial Reporting Council (FRC).

My strong belief is that the UKLA should form part of the CPMA and not the FRC for the following two key reasons.

1. It is folly to separate the regulation of the primary and secondary markets. The primary and secondary markets are inexorably intertwined and there is, I believe, no other country in the world which would entertain doing such a thing. There is a clear overlap between the market supervisory functions of the CPMA and the UKLA's primary functions of real time monitoring and response and implementation and enforcement. It is not clear to me how these functions have any relevance to the primary function of an accounting policy focused FRC.

2. The London market place in its broadest form is in competition to attract issuers and investors with other market places not just in Europe and the US but more importantly places like Shanghai and Hong Kong. It is imperative therefore that regulation of the primary and secondary markets is not only robust but is easy for practitioners to understand and to deal with. The separation of the UKLA from the

CPMA to the FRC will inevitably lead to additional cost in duplication and unnecessary bureaucracy. This may not seem important now but could be crucial as these other market places become more and more important and are able to attract pools of capital and issuers and investors.

There are of course many other reasons why putting the UKLA under the FRC would not make any business sense not least the fragmentation of effort in dealing with Brussels and also the more reflective culture of the FRC would inevitably dilute the more market orientated and immediate nature of the business of the UKLA.

In summary it is imperative the UKLA is placed with the CPMA.

Yours sincerely

Simon

Sir Simon Robertson

HMT Consultation (Cm7874):
"A New Approach to Financial Regulation: judgement, focus and stability"

Response by RBS Group plc

Executive Summary

Introduction

RBS Group plc („RBS') welcomes the opportunity to provide views on the Government's proposals to reform the UK's financial regulatory structure. These reforms are wide-ranging and important, and have the potential to make a significant impact on the future of the UK's financial services sector and its role in the wider domestic and global economy.

RBS fully recognises the direction set by the Government in its consultation and supports the need for change, both in the banking sector and its regulation. This response starts from a position that is broadly supportive of efforts to strengthen the UK's regulatory framework. The following comments are therefore aimed at helping achieve a framework that works well and one that, in addressing issues identified with the current "tripartite" framework, does not overlook potential challenges that the new structure may otherwise pose.

Our response mirrors the structure used in the HMT consultation paper. Our key comments on the consultation are reprised in this Executive Summary. More detailed points are made in the following sections, which reflect the consultation paper's chapter headings.

We would be happy to elaborate further on any of the points made in this response and look forward to engaging with, and supporting, the authorities as they take forward the extensive work that these reforms will require. In the first instance, any questions should be addressed to:

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Key Comments

We support efforts to strengthen the UK's regulatory framework and believe the proposals potentially offer a number of advantages – notably, more focused regulatory bodies, a better balance between conduct and prudential regulation, and a more holistic framework that aims to address wider financial stability and macro-prudential issues.

Whilst supportive of the proposals, we believe they can be further enhanced in certain areas. Issues we believe warrant further consideration include the following:

- The need to take into account risks arising from outside the regulated financial sector, and to strengthen further mechanisms for ensuring the overall consistency of macro-prudential, monetary and fiscal policies;

- The need to balance effective regulation with economic growth, for instance in the framing of a financial stability objective;
- Further strengthening of proposed governance and accountability mechanisms, particularly with respect to the Financial Policy Committee (FPC) and Prudential Regulatory Authority (PRA);
- The proposed dropping of competitiveness as a relevant factor for the new regulators – of concern given the UK's structural trade deficit and critical need for export earnings;
- Concerns over the suggestion that the PRA dispense with the important rule-making disciplines currently imposed on the FSA (such as consultation and cost-benefit analyses);
- The need to think through in detail how the co-ordination and duplication/underlap challenges of the new structure will be addressed – including how supervisory consistency can be maintained across the different bodies, and how differences between the Consumer Protection and Markets Authority (CPMA) and PRA would be resolved;
- The need for a balanced characterisation of the consumer protection agenda and to ensure that the regulation of wholesale markets is not compromised by the CPMA's retail responsibilities;
- Concerns over the likely adverse consequences of placing UKLA under the Department for Business, Innovation and Skills;
- Further strengthening of the institutional framework for crisis management and the need for a wider set of crisis management tools; and
- The need to focus on the EU context – in particular how the new framework will interact with the new EU regulatory structures now being created and how the UK can maximise its participation and influence in these.

The Bank of England and Financial Policy Committee (FPC)

A. High Level Comments

The need for a holistic framework

RBS fully supports the objective of ensuring a greater focus on systemic or aggregate risks across the financial system. Financial and wider economic stability, however, is not solely dependent on the financial sector. It is also dependent on the sustainability and effectiveness of monetary and fiscal policies, and ultimately on broader macro-economic and structural policies.

A coherent financial stability framework therefore also needs to address these other policy areas, and to ensure their overall effectiveness, consistency and sustainability. Whilst the proposed FPC should help to address risks to the wider economy arising from financial sector failings, it is not clear how risks to financial/economic stability arising out of other policy areas would be addressed in the new framework.

We would recommend, therefore, that further thought be given to this wider challenge and to possible solutions – for instance by extending the scope of reporting by the Monetary Policy Committee (MPC) and the Office for Budget Responsibility (OBR), so that the contribution of monetary and fiscal policies to financial and wider economic stability, and their consistency with the overall policy stance being pursued, is assessed and reported on.

Similarly, we consider that it is important that the identification of lessons to be learnt as regards the causes of the crisis should not solely be limited to the financial sector and associated regulation. As noted in Lord Turner's Review, and many other analyses, the crisis was also underpinned by underlying macro-economic problems - notably global imbalances and the consequences this had for monetary and fiscal policies. As far as we are aware, only limited consideration of these wider issues has been undertaken to date - a review of these issues could facilitate a balanced and comprehensive policy response.

Lastly, and more specifically, the macro-prudential tools to be deployed by the FPC to limit credit growth would not, in our view, sit easily with monetary and fiscal policies if these were not closely co-ordinated with other each other and consistent in their policy bias. Above all, macro-prudential tools should not be used to lean against excessive growth in the system to make up for the absence of policy action in other areas.

The risks of excessive prudence

As noted in the consultation paper, the macro-prudential tools to be deployed by the FPC could have far-reaching consequences for the financial sector and the wider economy. In framing an objective for the FPC it is important that it takes into account the need to strike an appropriate balance between effective regulation and economic growth.

Consistent also with our comments above on the need for a holistic system, it is important, therefore, that the Committee's financial stability objective be balanced by a responsibility to support sustainable growth. To give this counter-balancing consideration due weight, this should form part of the statutory objective, rather than be limited to a secondary factor.

Further consideration also needs to be given as to how overall consistency in policy is to be achieved, so as to avoid the risk that macro-prudential tools are used to do all the "heavy lifting". As currently proposed, consistency is to be achieved through executive cross-membership of the FPC and MPC. This could be strengthened by expanding the scope of reporting by the MPC and OBR and by increasing the number of external members of the FPC, so that they are in the majority.

Accountability

Given the significant impact that the FPC would have on the financial sector and the wider economy, accountability mechanisms need to be strong. We support the measures proposed in the consultation paper in this respect; further measures could usefully be considered as well.

Arrangements similar to those that apply with respect to monetary policy, for instance, could be explored, such that the Government is able to frame financial stability objectives for the FPC within the broader context of the Government's macro-economic objectives, on a regular basis, and that it can *in extremis* override decisions taken by the FPC with respect to the deployment of macro-prudential tools.

B. Responses to Specific Consultation Questions

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?

Given the importance of balancing financial stability considerations with economic growth and with the impact on UK competitiveness, we believe that these factors should sit alongside financial stability as part of the primary statutory objective(s) of the FPC, rather than relegated to secondary factors.

The financial stability objective for the FPC should, in other words, be counter-balanced by consideration for the competitiveness of the UK and economic growth in the wider economy, such that a balanced set of policies are pursued. Macro-prudential tools could potentially have major repercussions for the wider economy and should not be deployed lightly or without constraints placed on the FPC. This is particularly important given the nascent state of policy development and thinking about macro-prudential tools and what macro-prudential supervision can realistically achieve.

The FPC's objective(s) should also refer to the statutory objectives of the new regulatory authorities being established, in order to support the overall consistency and coherence of the whole framework.

The above primary objective(s) should in addition be supplemented by secondary factors, which would reinforce due process in terms of policy development and implementation (see our answer below in response to Question 2).

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

With regard to secondary factors, RBS believes that the following „have regard' clauses, currently outlined for the FSA under the FSMA 2000, should also apply to the FPC:

- the need to use its resources in the most efficient and economic way;
- the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits which are expected to result from the imposition of that burden or restriction; and
- the need to minimise adverse effects on competition that may arise from anything done in the discharge of its functions.

Specifically, the FPC should be required to analyse (and therefore have regard to), the downside risks as well as the potential benefits of using macro-prudential tools in the UK banking system, including its competitive position both domestically and internationally, and on the wider UK economy. Such an analysis should include an assessment of the scope for any restrictions on credit supply to be undermined by leakage in the unregulated sector or by foreign providers and the extent to which other factors (such as credit demand, monetary or fiscal policy) may be the underlying cause of the symptoms causing concern.

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

We believe that the sort of secondary factors highlighted under our response to Question 2 above could best be formulated in accordance with the approach taken under FSMA, i.e. as a list of "have regards".

Prudential Regulation Authority (PRA)

A. High Level Comments

We believe that the PRA's objectives should refer to the objectives of the FPC and the CPMA and that these should be strong considerations so as to maximise alignment of objectives across the framework. Similar to the FPC, we also believe that the PRA's objective for promoting the prudent and stable operation of the financial system should be counter-balanced by consideration for the competitiveness of the UK and economic growth in the wider economy, such that a balanced set of policies are pursued.

Given the open nature of the UK economy and the challenges faced by developed economies generally in adjusting to a world where terms of trade have shifted significantly in favour of many fast-growing emerging economies, we believe it critical that regard should be paid to competitiveness. In our view, competitiveness does not necessarily translate into weak standards – any such a concern can be addressed in the way the competitiveness objective is defined.

The proposal to dispense with some, or all, of the principles for good regulation is of significant concern and would benefit from further reflection. There are many examples where rule-making has benefited from the disciplines of consultation and cost-benefit analysis. Such processes provide opportunities not just for industry but for other key stakeholders as well (such as consumer groups) to make their views known; they have prevented errors in rule-making on various occasions.

Given the intention to move to a more judgement-based, interventionist prudential regime, which questions firms' strategies and business models and not just their risk management and controls, it is important that the PRA operates under strong accountability mechanisms and is as transparent as possible. We believe that any conflicts of interest of members relating to issues discussed by the Board should be managed on a case by case basis through individual members excusing themselves from particular discussions, rather than by "switching off" their collective input.

B. Responses to Specific Consultation Questions

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.***

Paragraph 1.6 states that a key reason for the failing of the current regulatory system was that no one body had overall responsibility / powers to tackle the problems that arose. Further, there was imperfect coordination between the tripartite members. The proposed revised system, even with the Bank of England (BoE) at the centre, potentially increases these risks given the number of bodies involved and the interactions required. Therefore, ensuring all of the principal bodies cross-refer to each others' objectives (in addition to sharing a certain commonality of approach in their primary objective(s), by including identical references to the need to consider impacts on the competitiveness of the UK and on economic growth in the wider economy) will help to enhance co-ordination and thereby minimise and manage the risks of under/overlaps and any differences in approach/requirements.

The financial services industry operates in an increasingly global market and therefore regulations imposed on UK firms can have a detrimental effect (e.g. restricting the ability of UK firms to compete, which can ultimately lead to the export of jobs and business from the UK). Although the papers states that "…*excessive concern for competitiveness leading to a generalised acceptance of a „light-touch' orthodoxy*…" contributed to the regulatory failure leading up to the crisis, this argument does not account for the many failures that took place in other regimes which were regulated under many different models and approaches (not all of which could be described as "light-touch"). The competitiveness requirement can in our view be retained within a framework and regulatory culture that does not encourage a "light-touch" approach.

It is important that the principles for good regulation, currently set out in section 2 of the Financial Services and Markets Act 2000 (FSMA), should be retained, particularly those relating to good regulatory practice. The approach of the regulators in applying these principles may not have been wholly effective but there is little wrong with the principles themselves and their loss would be damaging. This is particularly important given that the current popular and political desire for increased regulation may threaten economic growth and the competitive position of the UK unless it is balanced with appropriate consideration of the costs associated with regulation.

The requirement to have regard to potential adverse impacts of regulatory action on innovation should be retained. We also agree that the PRA should have regard to additional broader public interest considerations and thus should take into account the wider impacts on/implications for the industry which they are regulating.

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

It would be simpler and more efficient (in particular for firms regulated by both PRA and CPMA) to have one authority responsible for authorisation, permission and for approvals of firms and individuals. Logically, the PRA should undertake this task, at least for firms regulated by both the PRA and CPMA. An integrated model would encourage consistency and reduce the duplication of resources required by both regulators and firms. The alternative model, whereby both the PRA and CPMA would deal separately with authorisation, permissions and approval, would increase complexity and hence costs (which would ultimately be met by consumers), without delivering any additional benefit.

If the model selected is not integrated then the PRA should act as lead approver and individuals already approved by the PRA should be dealt with under a simplified CPMA process which provides approval automatically.

For firms subject to the CPMA but not PRA, we can see that it would make sense for the CPMA to deal with authorisation, permission and approvals (as proposed in paragraph 4.15). It would be important, however, that the CPMA and PRA apply a consistent approach in dealing with applications.

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

We agree that FSMA provides an appropriate framework on which to base the revised regulatory regime.

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

Regarding paragraphs 3.22 and 3.23, the process of consultation and engagement through stakeholder panels should continue as this is a key element in ensuring that rules have been considered in the light of industry/practitioner experience and that the principles of good regulation are fulfilled. Excluding practitioners and other interested parties (such as consumers) from the rule making process increases the risk of poorly drafted regulation which may have unintended side-effects. A recent example, for instance, were the initial proposals with respect to the Banking Act 2009, which would have undermined the applicability of netting and set-off for regulatory capital purposes, with major consequences for banks' regulatory capital positions and the status of London as an international financial centre. The issue only came to light and resolved through an extensive and constructive consultation and industry engagement process.

Cost-benefit analyses should also be continued, particularly given the desire in the current popular and political climate for additive regulation.

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

The regime could consider a streamlined approach which requires consultation on some, but not all, new rules. For example, rules which are adopted without amendment from EU directives could be excused further consultation, providing they were adequately consulted on at the EU level and provided they are simply being transposed without change into the PRA rulebook.

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.

We welcome the proposal to appoint NEDs to the Board of the PRA as this will improve the mechanism for its governance and accountability (even though appointments will need to be carefully managed and monitored). There is however scope for conflicts of interest to arise should NEDs have interests with individual firms, given that decisions regarding prudential oversight of individual firms will be made by the PRA Board, and this will of course need to be managed.

We hope that HMT will commit to providing a transparent set of criteria and process for the appointment of NEDs to the FPC, PRA and CPMA. We would also encourage HMT to bring this transparency to the appointment of independent members of the MPC.

Consumer Protection and Markets Authority (CPMA)

A. High Level Comments

We support an effective regulatory and supervisory regime for retail conduct of business issues. We believe that the regulator should work in favour of fair and reasonable outcomes for consumers, in which financial institutions are held to account in providing clear and understandable information, and consumers take responsibility for their decisions.

Whilst we broadly agree with the comment in paragraph 4.2 that prudential and conduct of business regulation require different approaches and cultures, we would question the notion that the consequent tensions that this can create no longer exist in a system with separate regulators. Tensions that were previously internalised within a single organisation will now be externalised and need to be resolved between separate bodies.

It is important that, in designing a system to address the faults of the previous framework, the inherent weaknesses of the new design are not overlooked. Thought should be given as to how these tensions will be managed, e.g. through the alignment of objectives (see comments in response to Question 10 below), and the operation of (UK-only) supervisory colleges.

In a similar vein, whilst the CPMA will have a more focused set of responsibilities, it should be recognised that retail and wholesale markets Conduct of Business (COB) regulation require significantly different approaches. It will be crucially important in our view that the CPMA is able to maintain an appropriate balance in its regulation of wholesale markets – failure to do so would pose a real threat to the continued success of the UK as a location for international financial services and markets.

Such differences will also pose management challenges. Staff will have very different skill-sets and cultures, with any required industry expertise coming from different parts of the industry. Managing such potentially strong binary differences will pose organisational challenges for the CPMA. Again, this is not to argue against the proposals, but to point out issues that will need to be addressed in order for the new framework to work effectively.

As discussed with respect to the PRA, the need to co-ordinate across more regulatory bodies will pose organisational challenges. We would urge as straightforward an interface as possible between firms and their regulators, in order to reduce complexity and administrative costs (which would otherwise ultimately have to be reflected in prices paid by consumers). The boundaries between authorities need to be clearly defined and, where there are likely to be overlaps, it needs to be clear who the lead authority will be in that situation. With both the CPMA and the PRA conducting prudential supervision, measures will also need to be put in place to reduce the risk of different treatment, which could create competitive distortions and heighten risks across the system.

Finally, we have significant concerns about the early references to the CPMA being a "consumer champion" or "strong consumer voice". There is a need for balance. Indeed, in his recent Mansion House speech, current FSA Chairman Lord Turner recognised the need for the CPMA to balance aims like product innovation versus product safety, and consumer protection versus consumer freedom to choose. RBS therefore firmly believes that a more constructive positioning would be for the regulator to work in favour of fair and reasonable outcomes for consumers in which they take responsibility for their decisions and in which financial institutions commit to providing clear and understandable information on which to make those decisions.

B. Responses to Specific Consultation Questions

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 the 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.***

Objectives

An important concern is that the different authorities may overlap (or underlap), creating the potential for inconsistencies of approach/requirements, and so losing the current advantages of having one regulatory authority. With the potential for inconsistency and confusion comes an additional administrative burden (and therefore cost) for firms, as well as an increased risk of non-compliance. Regulators, industry and consumers / business will benefit from the effective co-ordination of the FPC, PRA and CPMA, and RBS would support arrangements which help that to happen.

The CPMA should include financial stability considerations as part of its primary objectives (financial instability can significantly impair consumer protection/confidence in financial markets), together with (as argued above with respect to the PRA and FPC), consideration for the competitiveness of the UK and economic growth in the wider economy, such that a balanced set of policies are pursued.

Principles for good regulation

RBS strongly supports the retention of the current principles of good regulation and agrees with their overall intent. That said, there is an opportunity to improve the principles and ensure that these provide clarity of definition. This could also enshrine the need for a full and accurate cost-benefit analysis to be undertaken before introducing a regulatory change.

This is also an opportunity to ensure that the CPMA model fully enshrines better regulation, as defined by the Better Regulation Executive (BRE) - in particular the BRE Code of Practice of Guidance on Regulation[1], and the BRE's five principles of good regulation (transparent, accountable, proportionate, consistent and targeted).

There is an opportunity to ensure that the CPMA's "have regards" list be expanded to also acknowledge the responsibilities that can reasonably be expected of consumers. Whilst we are aware that a previous debate about consumer responsibilities (brought about the FSA Discussion Paper on this topic) did not result in any agreed changes, we believe that a great deal of consensus exists. We are aware that many consumer groups, and consumers themselves, agree that consumers have responsibilities too. This has been most commonly recognised in the concept of responsible borrowing. Indeed, we

[1] http://www.berr.gov.uk/files/file46950.pdf .

note that proposals currently being worked on by the EU Commission for a potential Directive on Mortgage Responsible Lending and Borrowing do, as the name suggests, include proposed requirements for borrowers to take certain steps which are within their control, such as providing accurate information about their finances. Customers should ensure that they understand and ask sufficient questions about the product they are seeking to purchase and the documentation they are given about that product. This is closely linked to the work of the CFEB on consumer education.

We would also propose that the "one in, one out" rule for regulations which the Government is introducing (as announced in the Coalition Agreement) is applied to the rules made by the CPMA and that this be done in a clear, transparent and accountable way by enshrining "one in, one out" within the principles.

Innovation

Championing innovation is vital to ensuring the maintenance of the competitive position of the UK as a leader in global financial services. Innovation can be perceived as having a tarnished reputation in the current environment but it is very important to the future success of financial services in the UK. Businesses need to innovate in order to respond to consumer demands and distinguish themselves from their competitors. Many customers want innovation and benefit from it. Benefits to retail consumers have ranged from new payment mechanisms and the development of remote banking and associated services, to more varied mortgage products (such as fixed or capped rate pricing and offset mortgages), that can better fit consumers' different needs.

RBS therefore believes that this principle should be retained. However, we agree that innovation should not be *"supported at all costs"* (paragraph 3.9 of the consultation paper). If the Government therefore feels that it needs to change, in some way, under the new structure then we would suggest that it be refined to something along the lines of: "*the desirability of facilitating innovation in connection with regulated activities, subject to appropriate risk management".* The aim of this would be to ensure the balance between innovation and the early identification, understanding and mitigation of the risks thus created. The CPMA could ensure that innovation is channelled in a way to suit the target customer base and market conditions (e.g. towards simplification and de-risking for unsophisticated customers if the market conditions are appropriate for that).

Competitiveness

As stated previously, we believe that the primary objective(s) of the CPMA (as well as of the PRA) should address competitiveness as part of a balanced approach to regulation, and thus disagree with the proposal in paragraph 4.11 that the CPMA should have no responsibility for maintaining UK competitiveness. In an increasingly globalised market, it is all the more important for the UK economy, which critically needs its financial services export earnings, to maintain and grow its competitive position. It is vitally important that UK regulatory authorities do not pursue stability or consumer protection regardless of the wider costs and impacts such measures may have on the competitiveness of the UK financial sector.

We do not accept that the UK standards were lower than elsewhere as a result of the FSA trying to attract more business to London. The reality is that FSA rules frequently went beyond minimum EU standards, as witnessed by previous complaints of UK "gold-plating" of EU legislation. And it is also the case that other regulatory regimes were no more successful than the UK in managing the financial crisis. The incidence of bank failures was more closely calibrated, in our view, to the extent to which national economies were subject to macro-economic imbalances rather than to different regulatory frameworks. Indeed, it seems that those economies that were less leveraged were those that fared relatively less badly during that period.

Broader public interest considerations

Paragraph 4.12 suggests that the CPMA might have regard to other public interest matters not currently in the principles of good regulation. RBS supports the idea of taking into account impacts on consumer and business lending, and to maintaining diversity in the financial services sector, providing these are not interpreted in a way that compromises the CPMA's objectives. There is, however, a potential conflict between responsible lending and the desire to see ever wider access to credit. It has been argued, for instance, that the political encouragement of widened access to housing finance in the US helped sow the seeds of the sub-prime crisis. Social policy considerations should, therefore, not be a key factor in CPMA regulatory decisions and should therefore not be on the "have regards" list.

The proposed consideration about *"promoting public understanding of the financial system"* may create confusion and the potential for overlap, given that this will be the role of a separate body - the CFEB. It would be simpler in our view to leave out this consideration, or to frame it in such a way as to make clear that the CPMA should simply support the CFEB in this respect, rather than take a prominent role itself.

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

In relation to governance, RBS agrees with the principles of ex-officio membership between the respective boards of the PRA and CPMA, and that the CPMA should be governed by a majority of non-executives. We would also recommend that, in addition to the expectation that such members have the necessary skills, the appointments process has appropriate checks and balances built into it in order to enhance consumer and industry confidence in the integrity of the system. This would also avoid potential accusations that the operation of the CPMA has been compromised. Additionally, we consider that the same processes should apply to the appointment of the members of its proposed executive committee and believe that there needs to be a robust set of examples regarding conflicts of interest that would prevent appointments being made.

We welcome the proposal contained in paragraph 4.30 of the consultation paper to establish the CPMA by adopting the legal corporate entity of the FSA, provided this does transpire to be the best value for money solution that it would appear to be.

In addition to the accountability mechanisms outlined in paragraph 4.36, RBS recommends that there be an annual public consultation regarding the CPMA's annual plan.

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

RBS believes that the panels have value and should therefore be maintained but that this is an ideal opportunity to improve the way that they function.

We feel that the Practitioners' Panel could be improved by giving key industry bodies (such as the BBA) membership of the Panel, generally widening membership and changing its name to "Industry Panel" or "Industry Experts' Panel". We believe that a wider membership of the Panel, subject to checks and balances to ensure impartiality is maintained, would be beneficial to the regulation of the financial services industry as a whole as the range of knowledge and experience available would be significantly enhanced. Underneath the main Panel, lower level committees could also be established to provide the required expertise at a less senior, but more detailed, level on relevant issues (as the main Panel has a very senior membership) – this is how the new Financial Ombudsman Service industry liaison has been structured. Perhaps there could be a committee for each product type or for themed issues such as debt matters. The Panel could be restructured in these and other ways to allow it to become a much more effective forum for constructive consultation with the industry at an early stage in policy development and a more effective route for the CPMA to gain industry expertise when it needs it.

Currently, the Consumer Panel consists of 11 members, some of whom have previously worked for consumer organisations. To ensure that the Panel is fully representative of consumers we would suggest that, going forward, the Consumer Panel would benefit from having current representatives from consumer groups such as Which? and the Citizens Advice Bureau. It also needs to have sufficient resource to conduct surveys of consumers so as to inform the Panel's views.

At present, the Panels meet separately and give advice from their different perspectives to the FSA. We believe that there is scope for the Panels to work more closely together to understand each other's position with the aim of reaching consensus. It would be beneficial, therefore, if the Panels met together regularly.

Transparency of the work of the Panels could be improved through enhanced information sharing and having them serve both the PRA and CPMA. This would help bind the two regulators closer together and increase the prospects of a more consistent approach, as well as strengthen the PRA's accountability.

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.

The impact assessment indicates transitional costs of some £50 million spread over three years. It seems likely that the highest costs will be borne by the 100 – 200 groups that contain both PRA and CPMA firms. Firms will require a measure of certainty regarding the potential individual costs so RBS recommends that the KPMG value-for-money study be extended to include the transitional aspects and their resultant costs, as well as the intended ongoing cost.

RBS supports the suggested levy collection model but wishes to ensure that the proposed architecture does not become more expensive than that of the current model. To achieve economies of scale with regard to day to day operations of the regulatory bodies, we strongly recommend that a "shared services" operating model be developed between them covering, for example, their HR and IT functions. Outsourcing of certain administrative functions could also be considered.

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

FSCS

With regard to the Financial Services Compensation Scheme (FSCS), the current EU proposals under the Deposit Compensation Scheme Directive (DGSD) and Investor Compensation Scheme Directive (ICSD) will have a bearing upon the method of levy, operation and setting of rules of the FSCS. RBS recommends that these schemes be administered jointly in order to minimise costs.

FOS and Consumer Redress

With regard to the Financial Ombudsman Service (FOS), we agree with the point made in paragraph 4.44 that it is important that it retains its independence. We note the adverse press commentary in early September criticising the FOS for compromising this through its participation in the "National Complaints Day" event and its competition that encouraged consumers to submit the best complaint in order to win an i-Pad. We consider that the independence and impartiality of the FOS will likely be even more important if the CPMA is to be a "consumer champion".

As the FOS structure is designed only to deal with individual complaints, rather than mass claim issues, it is essential that an effective alternative structure for dealing with mass claim issues is put in place. In our view, this means replacing the current Issues with Wider Implications (IWI) process with a better model which encourages and gives an opportunity to the industry to put matters right before an issue becomes a mass claim. The recent FSA, OFT and FOS consultation on this (Discussion Paper 10/1 – Consumer Complaints (Emerging Issues and Mass Claims)) proposed the establishment of a Co-ordination Committee on which the FSA, FOS and OFT would sit. RBS responded to this consultation to say that it is essential that the industry is properly engaged in this and that consumer groups are also able to have their say. We wonder what this would look like over the longer term if the OFT's consumer credit licensing powers were to move to the CPMA – would the OFT no longer have a role in this Committee? Would the Committee still be able to serve the same purpose in that event? These are questions which will need to be addressed during the forthcoming consultation on this.

RBS notes that whilst the consultation makes no mention of section 404 of the Financial Services Act 2010 (FSA consumer redress schemes), it is suggested that this be used as an opportunity to propose a review of those powers. There is a strong need for a collaborative approach between regulators, the industry and other interested parties, such as consumer groups, to be adopted with regard to the resolution of emerging risks, albeit one that allows for enforcement if collaboration proves ineffective. In situations where the section 404 power is used, safeguards are needed to allow the relevant firms to appeal the decisions of the FSA – decisions which could have a huge financial impact on those firms.

Consumer Financial Education Body (CFEB)

Given that the CFEB will be funded by a levy on the industry, we believe that the industry should be closely involved in its work and plans. Through close co-operation we will be able to ensure that the funding is used effectively and will complement the work of the industry. We also believe that the CFEB should work towards tangible targets to improve the financial education and capability of the country and that these targets should be the basis of the medium term review.

In relation to all of the above bodies, we would suggest that a review of their cost-effectiveness is undertaken annually by a body which can provide sufficient independent oversight, such as a Parliamentary Committee.

Consumer Credit

With reference to paragraphs 4.53 to 4.56, we note the drive for economies of scale that are needed in the current economic climate. Bearing this in mind, the movement of consumer credit regulation from the OFT to the CPMA to create a single consumer protection regulator for financial services seems to make a great deal of sense in principle. Potential benefits which could be derived from this include:

- A reduction in bureaucracy through a single consumer regulator for financial services rather than two.
- An overall reduction in costs by removing the current overlaps where crossovers presently exist.
- An improved model that consumers and businesses would understand better, rather than the elements of confusion that presently exist (such as the example regarding current accounts which is referred to in paragraph 4.55 of the consultation paper – namely that a current account is, at present, FSA-regulated whilst in credit and OFT-regulated whilst in overdraft).

We note that the Financial Services Consumer Panel and many consumer groups have in the past supported the migration of the OFT's powers to the FSA and would no doubt therefore support them moving to the FSA's conduct regulation successor, the CPMA.

Markets and Infrastructure

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

The logic for splitting responsibilities appears sensible. However, the Government notes the need for close co-ordination between the CPMA and the BoE in relation to (i) regulating market infrastructures and (ii) individual firms subject to regulation by both the BoE and the CPMA. Ensuring effective and efficient co-ordination will be challenging.

It is intended that the CPMA regulates "all financial instruments", although currently the BoE regulates the wholesale markets in non-investment products. These markets work effectively and there has been no regulatory failure. We would not want to see any change in the regulation of these markets. In the event of a default, the financial consequences to a CCP and/or settlement system may be so large as to require the support of the BoE to prevent systemic default. The BoE would be the most effective regulator for market infrastructure.

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

It seems sensible for the Government to consider possible rationalisation of the regulation of exchanges, trading platforms and clearing houses and to introduce a framework of regulation that will dovetail with any proposed changes to regulate financial markets at a European and international level. Further, we agree that the BoE should play a key role in the regulation of the wholesale market but seek further clarity over whether the "authorisation or licensing" of applicant exchanges, trading platforms and clearing houses will sit within the BoE or the CPMA. It would seem sensible that a streamlined approach is adopted where the whole "birth to death" process sits under one regulator to ensure consistency of treatment. Any rationalisation, however, should carefully consider the need for appropriate differentiation based on risk, so as to avoid any disproportionate impacts.

Under the existing regime, multilateral trading facilities (MTFs) can be operated by both authorised firms and Recognised Investment Exchanges. We would suggest that authorised firms operating an MTF also be considered for inclusion as a market infrastructure provider and that the conduct of providers of market infrastructure be consistent, regardless of the form they take. Consideration should also be given to including those firms that provide broker crossing networks in this category.

We would be fully supportive of the Government's proposal to consider whether there is scope for rationalising the two existing regimes, as referred to in para 5.17, under which the trading platforms and central clearing counterparties (CCPs) are regulated.

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 the BIS.

It is our understanding that the main purpose of the UKLA is to act on behalf of the FSA as the competent authority under Part VI of the FSMA. In this role, the UKLA places its focus on the companies which issue securities in the primary markets and then subsequently trade on the secondary markets. The UKLA also has the role of making and enforcing the Disclosure and Transparency Rules, the Listing Rules and the Prospectus Rules. Its role is more akin to market regulation (i.e. ensuring a consistency of disclosure and process for listed securities), thereby giving investors the comfort that disclosure rules are applied even-handedly for all types of listing applicant and providing certainty of process to the issuers, arrangers and sponsors who bring new issues to market.

It is our view that the UKLA's existing remit sits comfortably within the FSA's Markets and Capital Markets Section and that this close relationship within this Section assists in providing joined-up and sensible supervision of the primary and secondary markets. Therefore, we are unconvinced that merging the UKLA with the FRC, whose main purpose is to promote good corporate governance, and moving it under the umbrella of the BIS, will bring any benefits to the supervision of the primary or secondary markets; indeed, it is our belief that the separation of the supervision of the primary and secondary markets may lead to a disjoint of communication and governance between two distinct and separate organisations. The UKLA needs to maintain close access to the markets on which listed products are traded. Merging the UKLA with the FRC would seem to move it away from the close proximity that is central to its role.

In addition, listing authorisation for many specialist products such as covered bonds and securitisations would not sensibly sit within the BIS or FRC structure.

The UKLA has always enjoyed a good reputation for providing a professional service and we see the future standard most likely to continue under the governance of the CPMA. We see no benefit in moving the UKLA under the governance of the BIS through a merger with the FRC.

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.

Again, it is not obvious why more effective regulation of companies cannot be accommodated within the existing infrastructure.

Crisis Management

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

We support changes which will improve co-operation between UK authorities and reduce "underlap" in the build up to, and during, a financial crisis. Moving prudential supervision to the BoE should facilitate emerging risks across the system as a whole to be identified early so that steps can be taken to mitigate them before they become fully blown crises.

We note, however, that the new framework will continue to require co-operation not only between HMT and the BoE but also between the PRA and the BoE, and between the MPC and the FPC, as risks emerge. Should a crisis occur, tight coordination between the BoE, PRA and the Special Resolution Unit will also be required. The paper is short of detail as to how this will be effected, and it seems to us that the new structure lacks a formal structure for bringing together all key stakeholders. We are also concerned that the consultation paper does not make clear who will ultimately take the lead during a crisis; we believe this should be the Chancellor.

We therefore believe that the proposed crisis management framework needs strengthening. This should include the establishment of a financial equivalent of COBR. By creating a body now, which includes not only the Chancellor, HMT and the BoE, a clear allocation of responsibility and chain of escalation can be established. Such a body should also be responsible for overseeing "fire drills" to test the cooperation between the bodies involved. As was shown during 2007-08, the effective management of any crisis requires good and rapid communication between all parties – critically, that co-operation also needs to include external communication and how it is managed in the media. In an age when the media and financial reporting has an immediate impact on financial markets, it is vital that the authorities and industry representatives are seen to be adopting a common and pro-active stance.

We are also concerned that the tools outlined in the paragraphs 6.13 to 6.24 appear to concentrate on dealing with individual bank failures and are short on tools to respond to market stress events. As the consultation paper makes clear, no two crises are the same and it is possible that the next crisis could arise as a result of some factor other than the failure of an individual financial institution (e.g. a loss of confidence in "UK plc" by other countries). We would therefore encourage the development of tools which can support the market overall, as well as tools for dealing with "ailing" institutions.

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?

With regard to enhancing the "own initiative variation of permission" (OIVOP) powers, we would urge that these not be used as an easier alternative to undertaking quasi-enforcement action (without the safeguards that would apply to formal enforcement proceedings). We would also urge careful consideration before moving to mandatory intervention, as regulatory forbearance can be a powerful tool. We would, however, support the notion that greater clarity should be given on the use of OIVOP powers.

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?

There is currently no formal forum that makes the decision to invoke the SRR trigger. Rather than leave that decision to the CEO or Executive Board of the PRA, we suggest that a forum be created with representation from the PRA and the resolution side of the BoE. That forum would have the remit to formally review/discuss “watch-list” candidates ahead of deciding when/if to pull the trigger. This would also enable the resolution side of the BoE to have advance notice of possible SRR action. In addition, consideration should also be given to HMT participation, given its role in the deployment of certain SRR tools (e.g. nationalisation). The forum would then effectively become an operational committee for dealing with troubled institutions that may be heading towards SRR, a body that decides whether to trigger SRR and then a body that manages institutions in the SRR and the crisis. That forum could be the same body, separate from the COBR, that we have suggested in our response to Question 19. Such a body would also have the advantage of balancing potential conflicts – for instance, the PRA may be reluctant to trigger the SRR as it could be perceived to be an admission of failure on its part.

Impact Assessment

Question 22: As set out in Annex B, the Government welcomes comments from respondents on the assumptions made about transitional and ongoing costs for all types of firms.

Annex B states that preliminary transitional costs are expected to be £50 million over a three year period but “will be estimated more accurately based on consultation responses”; it is, however, difficult to comment without knowing further how that figure has been calculated. Whilst we appreciate the difficulties in undertaking impact assessments of this nature, we consider the material presented to be short on specifics.

We suspect that the £50 million quoted is likely to be a significant under-statement of transitional costs. Non-trivial costs for instance are likely to arise for firms from changes in reporting forms/processes and regulated status disclosures, as well as additional senior management time taken with overseeing these changes and interacting with new regulatory bodies. Changes to regulated status disclosures alone, for instance, could run to several millions of pounds for a large group, if changes are required outside of normal cycles for re-ordering stationery and the like.

Whilst we recognise that costs – even if multiples of the estimate presented – are unlikely to outweigh the perceived benefits of the proposed reforms, we would nonetheless urge a pragmatic and detail-focused approach that seeks to minimise unnecessary costs wherever possible. As mentioned, a flexible transition on regulated status disclosures alone, for instance, could save many millions.

Similarly, we would urge exploration of the feasibility of a shared services model, such that IT, HR and other support functions are shared across the new regulatory authorities and that single points of contact are used, wherever possible, for such matters as Approved Persons and reporting. This would help restrict costs of the new regulatory framework for firms (and ultimately for consumers of financial services), as well as facilitate greater consistency between the different regulatory bodies.

---End---

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Financial Regulation Strategy
HM Treasury
1 Horse Guards Road
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18 October 2010

Dear Sir/Madam

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

Royal & Sun Alliance Insurance plc, is a member of the RSA Insurance Group (RSA), a multinational insurance group writing business in 130 countries with major operations worldwide. In the UK, RSA operates solely in the general insurance market.

We welcome the opportunity to contribute to the Government's thinking on changes to the financial regulatory architecture. We are committed to co-operating closely and constructively with the Government to develop mutually beneficial solutions and ensure that the proposals are implemented effectively.

We are committed to good governance and control and are therefore eager to gain certainty on the regulatory structure in the UK as quickly as possible. We are also keen to achieve a system of supervision that ensures future financial stability and consumer protection while preserving and enhancing the status of London as the world's leading financial centre.

We have a number of concerns about how the planned 'twin peaks' approach will work in practice and have set out in this letter the main areas where we believe further clarity or work may be required. We believe that the proposals can be made to work efficiently and effectively with the right implementation. In particular, we welcome the enhanced role for the Bank of England which we believe will strengthen the credibility of the system and the UK financial sector. However, we would wish to highlight aspects where we believe improvements could be made.

It is important that the future regulatory architecture enables financial services firms to play an effective and valuable role in the economy providing support to both business and consumers. We strongly believe that the financial industry and the insurance sector in particular, should remain a thriving source of economic growth. They can and should play a central part in delivering a strong and sustained recovery at a time of continuing economic uncertainty.

It is also important that the new structure supports and encourages effective international co-ordination and avoids undermining the competitiveness of firms, the City of London and the wider financial services sector in the UK. This is all the more critical at a time of escalating international tax competition. It is essential that the Government ensures that the UK is not disadvantaged as a financial centre or tax domicile for firms relative to other key jurisdictions.

At the same time that we are undergoing considerable change in regulatory structure in the UK there is also a far-reaching overhaul of supervision being implemented at the European level. The three

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'Lamfalussy committees' are becoming European Supervisory Authorities (ESAs) with increased powers. The ESAs will have the power to ensure consistent standards of regulation across the EU and to intervene in a national regulator's jurisdiction in an emergency situation. The ESAs will also have the power to make binding technical standards which will complement the powers they already have to draft most of the prudential and conduct of business regulation implemented in the EU. With such major changes occurring at European level, the UK will need to have a clear plan for influencing European regulatory change so that it can achieve the best outcomes from emerging EU Directives and other regulation. Further clarity is required on which UK regulatory institution will be the primary contact for the ESAs as well as the mechanism to ensure that views across the industry and the regulatory bodies are appropriately reflected in Europe. We would hope that the Bank of England's role will give the UK an enhanced stature and authority in the EU, as well as the broader international fora such as G7 and G20.

We recognise that this is the first consultation on the new regulatory structure, however, the consultation appears to focus on the banking sector with too little mention of insurance. The insurance sector presents very different risks to banks, operating a radically different business model and it is important that both regulatory and supervisory processes reflect the reality that insurers and general insurers in particular, do not create systemic risk to financial stability.

To achieve this we recommend that insurance is given full and proportionate status relative to banking, particularly with regard to the Financial Policy Committee (FPC) and the Prudential Regulation Authority (PRA). We also strongly believe that this can only be achieved if these bodies are properly resourced with appropriately skilled staff with insurance expertise. We advocate the creation of a specialist UK committee of expert insurance supervisors to ensure that the industry-specific issues are fully comprehended and reflected in implementing reform.

The consultation provides some detail on co-ordination between the three bodies; the FPC, PRA and the Consumer Protection and Markets Authority (CPMA). The final rules should be very clear on how the interaction between the PRA and CPMA will work in practice. This should apply in particular to the CPMA's responsibility to consult with the PRA on conduct matters affecting the financial stability of individual firms and the financial services market. We are also concerned that the proposed institutions may fail to consider groups as a whole and action should be taken to ensure this does not occur.

A monitoring mechanism should be put in place to ensure that the proposed arrangements work in practice. There also needs to be information pooling between the bodies and a mechanism agreed for resolving material differences in analysis or action. The PRA and CPMA must co-ordinate on matters such as regulatory change. Firms regulated by both bodies should not be asked to implement multiple rule changes at the same time, as this could lead to confusion and duplication. To avoid this, we would recommend that the regime includes a provision to ensure that one body is at all times able to act as the lead regulator.

The new structure should carefully consider the practical implications for firms. For example, the potential for multiple visits to firms from different regulatory bodies is also likely to place an undue burden on resources.

We are also concerned about inconsistent regulatory approaches being adopted by the various regulatory bodies. The consultation refers to the PRA adopting 'judgement-based regulation' while it is unclear whether the CPMA is to employ a 'rules-based', 'principles-based' or 'outcomes-based' approach to conduct regulation and market supervision.

It is also essential that appropriate consideration is given to the funding arrangements. Having three regulators, two of which have already stated that they will be funded by industry, will almost certainly result in increased fees for firms regulated by both the PRA and CPMA. The Government will need to ensure that firms are not subject to 'double paying' for services.

The consultation discusses how the proposed FPC should be funded. We would argue that some or all funding for the Committee could come from the Bank of England's own existing revenue stream. Where, for example, there is a surplus, some of this revenue could also fund components of the work of the PRA.

The consultation paper refers to the CPMA as being a 'consumer champion'. We recognise that consumers, alongside businesses, should be the chief beneficiaries of effective financial regulation. But it is our opinion that it is inappropriate for the CPMA to be seen primarily as a 'consumer champion'. Instead, we believe that it must give due consideration to both the consumer interest and the wider impact on financial services of any rules imposed or actions taken which could adversely affect financial stability or economic growth.

Although we agree that the CPMA should have a clear objective that focuses on promoting and protecting the interests of consumers, we believe that this could create a conflict between being a 'strong consumer champion' and the 'principles of good regulation'. This is also incompatible with the CPMA's statement that there should be "no in-built tensions between different objectives".

We also believe that being a 'consumer champion' could result in the risk of CPMA focusing solely on consumer protection issues, potentially stifling the competitiveness that is essential for maintaining a strong financial services industry. In turn, such competitiveness provides consumer benefits through the development of customer-focused products and services as well as contributing to the financial strength of firms and the market as a whole.

We believe that the current proposal to have the new UK regulatory framework in place by 2012 will be very challenging. It is critical that the transitional arrangements minimise upheaval and also that in the interim the FSA is able to continue with business as usual without reducing its focus on other very significant regulatory developments, for example Solvency II.

Please find attached our detailed response to the questions in the consultation. We would welcome an opportunity to discuss our comments in more detail and would be willing to be involved in any working groups established to develop the proposals in more detail.

Yours faithfully

Derek Walsh
Group General Counsel

Response to Questions

The Bank of England and Financial Policy Committee (FPC)

We believe that it is vital that the FPC has a comprehensive and in-depth understanding of insurance; the substantial differences between banking and insurance in their funding models, their impact on the economy, consumers and financial stability as well as the value that insurance provides in the economy and society.

To ensure that this can be achieved we believe that there should be sufficient representation of the insurance sector on the FPC. This can be achieved by ensuring that the external representatives have significant insurance experience and would urge that at least one of the external representatives (preferably more) should be drawn directly from the insurance sector. It would also be beneficial if there were substantial expert knowledge of insurance among internal members of the Committee.

In paragraph 2.32, the FPC's roles include 'giving directions to the PRA (and, if relevant, the CPMA) on the regulatory tools that should be deployed' and 'making recommendations to the PRA and CPMA where the FPC believes that specific regulatory actions are required'. Further clarity is required on how this will operate in practice. We recognise, however, that the thrust of these proposals is to deploy new 'macro-prudential tools' to improve the delivery of financial stability. This is therefore chiefly about regulation of the banking sector, credit creation and maturity transformation and so does not directly bear on the insurance industry. In any event, a better understanding of the impact on our sector is required.

The funding of the FPC should be appropriate and proportionate to the activities that it is undertaking and we would welcome further clarity and consultation on the detailed proposals. Since the chief rationale for the creation of the FPC is to prevent a repetition of the banking excesses that led to the global financial crisis, we believe a large component of the funding for the FPC could come from the Bank's existing revenue streams through the cash ratio deposit scheme, as well as from the returns that the Bank makes from the commercial banking sector's banknote issuance and distribution activities.

Also, there is little mention of interaction with the new EU regulatory framework. Further information is needed on how the FPC will interact with the EU bodies, in particular the European Systemic Risk Board (ESRB). We welcome the added authority that the role of the Bank of England will bring to UK representation in international fora; it is vital to maintaining the City's stature as a financial centre.

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?
The FPC's objectives should be supplemented with secondary objectives so that it can be accountable for the impact of its decisions on regulated firms and on the market as a whole.

Q2: If you support the idea of secondary factors, what types of factors should be applied to the FPC?
We agree with the secondary factors outlined in paragraph 2.28 of the consultation; the FPC should have regard to the economic, fiscal and social impact of its macro-prudential decisions. We also believe that the FPC should have regard to UK competitiveness so that the UK financial services sector is not disadvantaged in comparison to our competitors in other markets.

Q3: How should these factors be formulated in legislation – for example, as a list of 'have regards' as is currently the case in the Financial Services and Markets Act 2000 (FSMA), or as a set of secondary statutory objectives which the FPC must balance?
These factors should be detailed as a set of secondary statutory objectives. The legislation could, for example, sensibly include a legal obligation on the FPC to demonstrate how its decisions are consistent with the aims and actions of the PRA and CPMA.

Prudential regulation authority (PRA)

Q4: The Government welcomes respondents' views on:

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

We are satisfied that with active cooperation between the Government, the proposed authorities and the financial sector, the new regulatory regime can be made to work effectively and improve on past practice. To ensure this effectiveness, however, it is essential that there is rigorous coordination between the main bodies. The PRA should have regard to the primary objective of the CPMA and vice versa to ensure a coordinated approach to regulation. We also believe that the PRA and CPMA should have regard to the FPC's objective of ensuring financial stability.

The PRA's objectives should include the existing principles of good regulation as currently applied to the financial industry, in particular 'the need to manage resources in the most efficient and economic way' and preserving 'the international character of financial services and markets and the desirability of maintaining the competitive position of the UK'.

While having a strong regulatory environment is a competitive advantage for UK firms it is essential that regulation does not damage the UK's competitiveness with other financial services markets. Preserving the existing success of the City as a global financial centre will be crucial to delivering a strong and sustained economic recovery and allow the financial sector to continue to provide a source of tax revenue for finance public services at a time of spending restraint.

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

An integrated model would be preferable as it would be a more efficient use of resource and process and would also minimise the considerable risk of costly duplication of services which will be counter productive and inefficient. An effective solution would be the creation of a shared services body reporting equally to the CPMA and the PRA. The integrated body could also be responsible for approving all decisions in relation to authorisations, approvals and other administration such as fee collection. This joint body could also act as a secondary check on the level of co-operation between the CPMA and the PRA. Ideally, there should be a system of accountability through which the regulators demonstrate they are cooperating and avoiding duplication and provides a means of accountability to redress inefficiencies. Regulated firms should be involved this process.

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?

Reducing the excessive size of the current FSA Handbook and the onerous compliance costs it imposes on both firms and regulators would be a welcome initiative. However, splitting the Financial Services and Markets Act (FSMA) into prudential and conduct regulation under new legislation will be extremely difficult given that FSMA was specifically written for a combined prudential and conduct of business regulator.

There needs to be a robust process around the areas of FSMA that will be picked up jointly on a co-operative basis (i.e. could not be directly assigned to either the PRA or CPMA) to avoid the risk of over or under supervision of these areas. As mentioned in the response to the previous question some of these activities could be undertaken by a shared services body.

As mentioned in our introductory letter, most regulation is derived from EU Directives. The requirement to demonstrate that EU Directives have been implemented in Member States will remain. Also, as mentioned above the new European Supervisory Authorities will have the power to make binding technical standards which will have to be adopted by national regulators. The PRA should be constituted to maximise the UK's influence on the European Insurance and Occupational Pensions Authority (EIOPA).

The PRA proposes not to consult on rule changes or undertake any cost benefit analysis when doing so. We do not believe that this is acceptable to the industry as broad-based consultation has proved to be an important part of the decision-making process and allows regulators to understand more fully the practical implications of the rules they are considering. It is essential that consultation on new rules and thorough assessment of impacts be maintained by the PRA if the cost and burden of regulation is not to become disproportionate. We believe strongly that the PRA should retain all of the checks and balances contained within FSMA with respect to drafting new regulation.

Q7: Are safeguards on the PRA's rule-making function required?
Yes. The PRA should be subject to all of the existing the safeguards in rule-making

Q8: If safeguards are required, how should the current FSMA safeguards be streamlined?
We do not believe that the safeguards should be streamlined. They are there to ensure that rules are drafted and implemented in a fair and robust way and that the cost and burden of compliance does not become disproportionate. The consultation paper provides little rationale for removing such safeguards. However, we would always welcome measures that make these processes more efficient and reduce compliance costs.

Q9: The Government welcomes views on the measures proposed in paragraphs 3.28 to 3.41, which are designed to ensure that the operation of the PRA is transparent, operationally independent and accountable.
The membership of the PRA Board is highly aligned to the existing Bank of England structures, which could lead to a potentially excessive focus on banking sector issues at the expense of other key parts of the financial industry. At the same time, there is a lack of detail on how insurance regulation and supervision will be structured so that there are appropriate skills and experience at the senior levels of the PRA. We believe that deep expertise in insurance is a crucial component of making supervision effective. There should be representation on the PRA Board of senior experts with insurance experience and at least half of the non-executive directors should be from an insurance background. The PRA's Executive should also include a Head of Insurance Regulation and Supervision to give insurance firms a voice at the senior level of the PRA.

Consumer protection and markets authority (CPMA)

The Government should use the principles of good regulation in shaping the strategic objectives of the new regulator. The CPMA should have clear primary objectives that focus on protecting the interests of consumers and on ensuring the integrity of the financial services market. It is also essential that the CPMA pays proper regard to financial stability at all levels and recognises that actions that adversely impact the stability of firms or the market are unlikely to be in the best interests of consumers.

We are concerned that the CPMA's roles as 'strong consumer champion' and 'principles of good regulation' may be inconsistent with the CPMA's statement about "no in-built tensions between different objectives" and an indicator of the CPMA's focus on the consumer to the potential detriment of product providers and distributors.

We believe that there should be reference to 'competition' in the Government's proposals and that the CPMA should seek to understand the benefits that competition and innovation can deliver. Similarly, the CPMA should be alert to the impact that its wide ranging powers of intervention could have on competitiveness given the importance of the UK financial services sector.

There is also potential for inconsistencies in the approach by the PRA and CPMA. The PRA refers to 'judgement-based regulation' while it is unclear if the CPMA will take a 'rules-based', 'principles-based' or 'outcomes-based' approach to conduct regulation. We believe that regulators should understand the markets that they regulate and focus activities on areas where there is the greatest risk of detriment. We would advocate the application of an 'outcomes-based' approach as the ideal model.

Q10: The Government welcomes respondents' views on:

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

The decision to split the responsibility for the regulation of firms between the PRA and the CPMA raises the potential risk of unnecessary and costly duplication and/or the risk that the two bodies will diverge to the extent that the actions of one are contradictory to the aims and objectives of the other. An example of the latter might arise in circumstances where the actions taken by the CPMA impact on the financial stability of individual firms, specific market sectors, or the financial system as a whole.

Therefore, if prudential and conduct regulation are split, it is essential that the CPMA pays proper regard to financial stability at all levels. Their stated primary objective is "ensuring confidence in financial services with particular focus on protecting consumers". Actions which result adversely on the stability of firms or the financial services market are unlikely to be in the best interests of consumers.

For firms such as insurers, that will be directly regulated by both the PRA and CPMA, it is essential that the actions of either regulator are given due regard by both bodies.

- ***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.***

We believe that all of the principles of good regulation should be retained. It is also our view that a further principle should be included, relating to the CPMA attaining and maintaining an appropriate level of understanding of the firms and markets they regulate. Without this understanding, the CPMA will be unable to make sound judgements about the strategies, plans and actions taken by individual firms.

On a more practical level, it is also essential that the CPMA understands the potential impact that regulations and supervisory actions taken against individual firms might have on the financial system as a whole. This is consistent with their objective of co-operation between regulators to ensure effective regulation.

On a related matter, we are also concerned about the statement in Paragraph 4.8 that "in the case of a direct conflict between primary and secondary objectives, the Government would generally expect the primary objective to override any secondary considerations". If a primary objective of the CPMA includes "..with particular focus on protecting consumers.. ", the CPMA can impose any regulation and/or sanctions it chooses without due regard to, for example, the secondary objective of "a burden that is imposed on a person should be proportionate to the benefits which are expected to result from the imposition of the burden".

We believe the statement in paragraph 4.8 is inappropriate and that, in all circumstances, the CPMA should give balanced consideration to the needs of consumers, the burdens on firms and the impact on the financial system as a whole.

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

We note the Government's comments on innovation and global competitiveness and their concerns that this might conflict with the CPMA's role as a dedicated conduct regulator. However, in our view, these principles should be retained.

It is our opinion that it is inappropriate for the CPMA to be seen primarily as a 'consumer champion'. The role of the CPMA, as conduct regulator, must require them to give due consideration to both consumers and the wider impact on the financial services industry of any rules imposed and actions taken.

Market innovation and competitiveness, whether on a local or global level, is essential for the development and maintenance of a strong financial services industry. In turn it can provide consumer benefits through the development of new customer-focused product and service propositions, as well as contributing to the financial strength of firms and the market as a whole.

It is the role of the regulator to be flexible to support these objectives by, as mentioned above, ensuring they fully understand the firms they regulate, the markets in which they operate, and the potential impact of their actions on an individual firm's or market sector's ability to operate effectively and competitively.

The balance, in the form of adequate consumer protection, should be achieved through effective regulation and supervision by the CPMA, in conjunction with the PRA and FPC as necessary.

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

We are not aware of any further considerations at this time. However, it is essential that in the event that further public interest considerations do arise the CPMA consult with the industry and other interested bodies in accordance with statutory processes, including market failure and cost benefit analyses, prior to inclusion.

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

In our view, the accountability mechanisms appear relatively adequate and we welcome, in particular, the proposals regarding audit by the National Audit Office. However, we feel it should be clear that part of the objectives of these mechanisms should be to ensure that the CPMA:

- fulfils its requirements to liaise with both the PRA and FPC;
- gives appropriate consideration to the interests of the financial services market and the firms it regulates; and
- does not impose unnecessary costs, regulation and / or enforcement action in its desire to be seen as a consumer champion.

We would like to see further information on how the proposed mechanisms will achieve the above. There should be a clearly defined, systematic mechanism for the industry to have input on delivery of these objectives.

Q12: The Government welcomes views on the role and membership of the three proposed statutory panels for the CPMA.
We welcome the Government's proposals to retain the Consumer and Practitioner Panels, and to include for the first time the Small Business Practitioner Panel as a statutory body. We have no comments on the role and membership of these panels, except to say that in order to be effective and credible representatives of the industry's views, they should continue to represent the wider financial services markets and to operate independently from the CPMA.

However, we also call upon the CPMA (and the PRA) to continue the valuable relationships and consultation arrangements (both formal and informal) established by the FSA with other industry bodies, such as the ABI, BIBA, BBA and CML.

For the insurance industry, the access to the FSA enjoyed by the ABI (and vice versa) has:

- provided the FSA with valuable access to a 'sounding board' for informal discussions about emerging regulatory issues;
- enabled full and informed consultation with representatives of the financial services industry;
- provided the FSA and ABI opportunities to discuss the regulator's expectations of insurers, leading to greater understanding and adherence to regulation; and
- resulted in co-operation regarding key regulatory issues and market failures.

Examples of the latter include:

- the remedial actions agreed following the FSA's review of unfair variation terms in PPI contracts;
- the development and agreement of the contract certainty code of practice; and
- agreement of industry guidance on transparency, disclosure and conflicts of interest in commercial insurance.

We believe that the CPMA and PRA should ensure these mutually beneficial relationships continue.

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 welcome the proposal for one regulator to be responsible for the collection of all fees and levies, on the assumption that this will avoid the duplication of services and reduce the costs to the industry. As stated in the consultation, it makes sense for this role to be performed by the CPMA.

We would also welcome proposals for other services to be shared, for example:

- authorisation of firms;
- supervision of firms, such as insurers, who are regulated by both the PRA and CPMA, avoiding duplication and reducing costs of supervisory visits, reporting, statutory notifications etc;
- applications for passporting / establishing EEA branches that may include both prudential and conduct requirements (e.g. Non-Life Directives and Insurance Mediation), thereby also establishing one point of contact for European regulators; and
- applications for and administration of approved persons, especially those whose responsibilities are regulated by both the PRA and CPMA.

This would simplify and speed up processes, avoid duplication for firms and regulators, achieve cost savings in the transition to the new regulatory framework, reduce infrastructure costs (e.g. computer systems such as GABRIEL and ONA) and reduce the financial burden of regulation.

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

We would strongly support an operating model that no longer included the cross-subsidy of compensation claims between different classes of business. However, there is currently insufficient evidence for us to make a definitive decision on whether this is best achieved by the operation of two schemes, or one scheme operating under a different funding model. In either situation, however, we believe the scheme or schemes should be operated by a single organisation in order to share functions and achieve appropriate cost savings. There is considerable ongoing work at EU level on proposals for Insurance Guarantee Schemes. We would urge the Treasury to pay close regard to these developments when considering the future of the FSCS and of the present regime of cross-sector subsidisation.

Markets and infrastructure

Q15: The Government welcomes views on the proposed division of responsibilities for markets and infrastructure regulation.
Not applicable.

Q16: The Government welcomes views on the possible rationalisation of the FSMA regimes for regulating exchanges, trading platforms and clearing houses.
Not applicable.

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 recognise the intent behind the proposals to merge the UK Listings Authority (UKLA) with the Financial Reporting Council (FRC) as a means of improving the framework for company reporting, audit and corporate governance. We would support the spirit of the forthcoming review by the Department for Business in seeking to ensure the highest standards of corporate governance.

However, while acknowledging some of the merits underpinning the Government's thinking on a UKLA merger with the FRC, we believe that the counter-arguments, some of which are set out in the consultation itself, outweigh these. In particular, we agree with the concern expressed by the Treasury over the potential loss of synergies between the Listings Authority and the other market supervision functions to be placed within the CPMA, especially market surveillance. In addition, we believe that:

- a merger with the FRC could in practice detract from the Financial Reporting Council's effectiveness in promoting corporate governance;
- a merger with the FRC would mean greater fragmentation of the regulatory architecture as a whole;
- merger with the FRC would inappropriately split regulation of primary and secondary securities markets leading to coordination difficulties;
- the CPMA provides a more effective location for the UKLA given the nature of the real-time decision making required by the Listings Authority over issues such as market suspension. While this sits well with the CPMA's own operation it contrasts sharply with the more deliberative nature of decision-making presently used by the FRC; and
- CPMA is also a more effective location for UKLA since CPMA is represented at the new European securities regulator, ESMA, while FRC is not. Placing the Listings Authority under the FRC will effectively deprive it of a voice at the European level, potentially placing London at a competitive disadvantage as a financial centre.

Q18: The Government would also welcome views on whether there are other aspects of financial market regulation which could be made more effective by being moved into the proposed new companies regulator.
We recognise the importance attached by the Government, including the Department for Business, to improving corporate governance and market regulation. However, given the present scale of change across the regulatory landscape we would urge that a period of consolidation and stabilisation is needed before any further reforms that might give rise to transitional costs.

Crisis management

We welcome the need for effective co-ordination during a significant financial crisis, however, we do not agree that further resolution powers are required for the insurance sector and for general insurance especially. Insurers have not contributed to the recent financial crisis and it is widely recognised that the general insurance sector does not create systemic risk to financial stability. Systemic risks do not arise from insurance as the sector does not engage in either credit creation or maturity transformation, nor is it possible for there to be a run on an insurer. The proposals are focused on the banking sector and we would want to see proposals that take into account the different risks and business models of the insurance sector to avoid the unintended consequences of mandatory intervention.

Q19: Do you have any overall comments on the arrangements for crisis management?
The proposals appear to have been designed to reflect a focus on banking. Specific arrangements and processes should be developed for insurers to reflect the points we have made above.

Q20: What further powers of heightened supervision should be made available to the PRA and the CPMA, and in particular would there be advantages to mandatory intervention, as described in paragraph 6.17?
We do not believe that further resolution powers are needed for the general insurance sector. The sector does not create systemic risk as general insurers are able to run off their liabilities over a longer period of time.

We do not believe mandatory intervention will improve supervisory powers as these powers could reduce the flexibility afforded to regulators to develop a mutually beneficial solution with the firm.

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 do not think it is appropriate to introduce more onerous burdens while the regulatory architecture is shifting.

Impact assessment

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

We believe that the estimate for transitional fees of £50m over three years is modest. HMT should consider that there will not only be transitional costs but potentially a significant increase in fees for firms to fund three regulatory bodies (including the FPC if the current funding arrangements are modified as detailed in the consultation).

We disagree with the Government's consideration of extending "supervisory powers to cover unregulated holding companies and unregulated entities within the Group structure of financial institutions such as banks and insurers". To adequately supervise a Group's unregulated entities the PRA would need to significantly increase resources. Under the current regulatory structure supervisors can request any information that is required on an unregulated holding company or an unregulated entity. The FSA also already considers any potential for contagion risk from these entities on the regulated firm.

A NEW APPROACH TO FINANCIAL REGULATION

I am writing in response to the consultation paper published by HMT in July 2010. I only wish to comment on Q17 referring to the proposal to merge the UK Listing Authority with the Financial Reporting Council. I wish to bring to your attention some of the history of the UKLA and I believe I am in a good position to do so. In 2000 I was appointed Head of the UKLA and Director of the Listing Division of the FSA. This was soon after the UKLA was transferred from the London Stock Exchange to the FSA following the demutualisation and flotation of the LSE. It was a difficult time for the UKLA as many experienced staff resigned and those who stayed needed to get used to a very different culture operating in the FSA. We succeeded in rebuilding the team and I would argue that the change in culture was a positive step forward in that the UKLA was seen to be tough and fair while being more "market savvy". The UKLA also had the considerable benefit of being able to consult staff in other FSA divisions when issues arose affecting firms regulated by the FSA. Before I retired from the FSA in 2004 I proposed the merger of the UKLA with the Markets and Exchanges Division to produce a coherent and stronger Markets Division to regulate primary and secondary markets. Although cost savings were part of the rationale for this merger I believed a single joined up Division would be more effective, particularly in supervising market conduct. It would also offer more obvious and varied career paths for the talented staff in the Division. So far as I know the merger has been a success but I have been out of touch with the FSA for some time. I did however spend nearly a year advising the FRC on one of its corporate governance reviews. While I support the work of the FRC in this area, I know how thin are its resources and I have a good feel for the culture of that institution. I am concerned that transferring the UKLA to the FRC would be a backward step and would risk undoing many of the improvements that have been made to the effectiveness of the UKLA over the last decade.

One of the arguments being used to support the proposal is that it would bring the UKLA closer to the source of corporate governance best practice. I am now a corporate governance consultant and I know how limited are the responsibilities of the UKLA in this area. All that is required by the Listing Rules is that a listed company includes a corporate governance statement in its Annual Report showing how it has applied the principles of the Code and showing whether it complies with the provisions of the Code or explaining why it does not. The UKLA merely checks, on a limited sample basis, whether these disclosures are included in the Annual Report but makes no judgement on their contents.

I would urge you to reconsider this proposal and to resist breaking up the Markets Division so as to allow the UKLA to be transferred to the proposed CPMA.

I have kept this response deliberately brief and would be happy to talk to anybody in HMT if you so wish.

Ken Rushton

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

By email to: *financial.reform@hmtreasury.gsi.gov.uk*

15 October 2010

Dear Sirs

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

I am writing on behalf of SABMiller plc in response to the above Treasury consultation paper, with particular reference to the proposal set out in Chapter 5 to split off the UKLA and make it part of the FRC.

We participated in the preparation of the submission dated 15 October 2010 from the GC100 (the association for general counsel and company secretaries of companies in the FTSE100), and we endorse all of the comments made in that submission.

Thank you for the opportunity to comment on this proposal.

Yours faithfully

John Davidson
General Counsel and Group Secretary
SABMiller plc

1. Single unconstrained objective would be best. Factors just clog up the statute book.
2. N/A.
3. Statutory objectives are preferable if any are required.
4. Yes
Yes
Yes
the protection of consumers - this may seem odd but actually when considering prudential matters, consumer protection should be considered.
5. One authority is always preferable as it is for the whole system. Multiple authorities lead to things falling through the cracks.
6. No. This will make no difference at all. Regulation is about the people who do it, not the legal or regulatory structures. We currently employ regulators who are scared of those they regulate. While that continues, the changes proposed will have little or no positive effect.
7 No. The FSA actually doesn't use its powers enough.
8 Not applicable
9 They would make very little difference. Again see 6.
10 Not necessary.
All of them. Changing the regulatory structure only creates confusion. We need better quality individuals regulating not two years of disruption which is why the Government's breach of the coalition agreement in deciding to re-name the FSA the CPMA is so outrageous.
It's fairly harmless.
FSMA is perfectly adequate for this purpose. Tampering will not help.
11. Probably but unless you change the people running it, it will not work.
12. The consumer panel needs a paid for technical adviser. Otherwise, it cannot possible fulfil its remit.
13 and 14 The current approach of polluters' competitors pays is unfair and impractical and has to be re-negotiated virtually annually. It makes more sense to make regulated firms pay across the Board in line with their ability to pay not the function they perform.
15 Any division of responsibility here is inappropriate since it creates gaps in the regulatory coverage.
16 Short answer - don't try. Fiddling with these things is just expensive and disruptive. If the Government is really committed to handing back prudential regulation to the Bank of England to repeat its perfomance on BCCI, just keep the FSA holding all the remaining functions. More change just costs money, creates chaos and results in a holiday from effective regulation until everything settles down.
17 No. Just keep it where it is. Change for changes sake is pointless. The listing authority has worked pretty well at the FSA. Why move it?
18. Nothing regulated by the FSA. See 17.

Overall, the proposals represent Governmental vandalism in breach of the Coalition Agreement and the popular vote more than half of which went to manifestos that proposed little or no change to the regulatory structures. The Bank of England had if anything an even worse record than the FSA of regulating banks in that it mishandled some easy scandals whereas the FSA picked up a total meltdown. Morale at the FSA has been destroyed by the proposals with large scale departures of senior staff. The Government is supposed to be cutting back on public spending but all its proposals cost money and in the case of renaming the FSA the CPMA an enormous waste of it to no obvious purpose. These proposals are truly appalling.

Adam Samuel

Thank you for the opportunity to respond to the consultation.

Shared Interest is an Industrial and Provident Society (IPS) based in Newcastle upon Tyne and lending to businesses engaged in fair trade (both buyers in the developed world and producers in the developing world). We are 20 years old and have about £28m of capital invested by around 9,000 people – individuals in the main.

We would like to respond on one key aspect of the consultation only and that is around the destination of the Register of Industrial and Provident Societies after the changes. The consultation does not deal with this specifically, but we believe the ideal outcome would be to create a new IPS Registrar within Companies House. They should retain the important role of the current Registrar in checking the eligibility to register or make rules changes but would also bring the transparency and efficiency of the current Companies House operation to the sector. It would be very important that this role is performed by someone who is knowledgeable about the sector and its aims.

If the above outcome is not feasible then our second preference would be that registration of IPS's stays with the successor bodies of the FSA and of these the CPMA looks to be the most appropriate.

We do not feel that transferring the register to a non-specific part of Companies House makes sense and would be strongly opposed to any approach which simply transferred it to the "highest bidder".

I would be happy to discuss these views further at any stage.

Thank you

Tim Morgan
Finance Director & Company Secretary

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12 October 2010

Via Email: financial.reform@hmtreasury.gsi.gov.uk

Financial Regulation Strategy
HM Treasury
1 Horse Guards Road
London

Dear Sirs:

We refer to your consultation document dated 26 July 2010 and entitled "A new approach to financial regulation: judgement, focus and stability" (the "**Consultation Document**").

The purpose of this letter is to provide comments on some of the issues raised in the Consultation Document. Shearman & Sterling is an international law firm with offices in major financial centres across the world. We advise many of the world's leading financial institutions, companies and governments on the full range of corporate and financial regulatory issues. We have experience with all of the main bank and securities regulatory agencies worldwide.

Our comments focus on the issues raised by the Consultation Document in relation to the Prudential Regulation Authority (the "**PRA**"), in particular, the powers and functions of the PRA. The relevant paragraphs in the Consultation Document are 3.17 to 3.41 and the relevant questions are 6 to 9.

Please note that these responses and amendments are not made on behalf of, and should not be attributed to, any client of our firm.

Paragraphs 3.17 to 3.20: *"3.17 The Government's goal is that the legal framework for the PRA should underpin a more informed and judgemental approach to regulation. To this end, Government will examine the adequacy of FSMA as a template for the legal framework governing the operation of the PRA. The Government will consider whether any modifications or alternatives to FSMA are required to accomplish the objective of judgement-led prudential regulation, bearing in mind the importance of adhering to the two-year*

legislative timetable to which the Government is committed. In doing so, it will work with the Bank and FSA, and is also seeking the views of respondents on this point.
3.18 Assuming that FSMA is to be the model for the PRA's legal framework, the Government will legislate to divide the powers and functions set out in FSMA into separate standalone prudential and conduct regulation frameworks. To prepare this legislation, the Treasury will systematically work through FSMA – drawing on the expertise of the Bank of England and the FSA – to establish which of the current powers and functions provided for within FSMA each of the new authorities will require in their specific areas of responsibility, and any necessary modifications. In some cases, it may be appropriate for powers and function to be transferred exclusively to either the PRA or the CPMA; in other cases, there may need to be overlapping powers and functions. As discussed above, where there is such overlap, arrangements will be put in place to ensure that the authorities coordinate action appropriately to minimise the burden for firms.
3.19 The Government will consult on draft legislation to provide the necessary powers and functions to the PRA and CPMA. This consultation will take place in early 2011, well in advance of the introduction of legislation to Parliament (more detail on the implementation timetable is set out in Chapter 7).
3.20 The key functions of the PRA, supported by the necessary legal powers, will include:
- *exercising judgements about the safety and soundness of financial firms, and taking appropriate action;*
- *the core regulatory function of making the rules which govern the performance of regulated activities by financial firms;*
- *the authorisation of firms via the provision of permissions to firms to engage in regulated activities;*
- *supervision, and where necessary, enforcement of compliance with rules;*
- *the approval of individuals to perform certain controlled functions within financial firms; and*
- *the raising of levies to fund the activities of the PRA."*

Rulemaking: statutory processes - paragraphs 3.21 to 3.23

Paragraphs 3.21 to 3.23: *"The PRA will be responsible for making prudential rules for the firms it regulates, covering all issues affecting the safety and soundness of individual firms (including, for example, remuneration). Rule-making will be a function of the PRA board which cannot be delegated to a sub-committee or members of the executive.*

3.22 The Government is considering whether the rule-making function should continue to be subject to statutory processes, including consultation with a practitioner panel, wider public consultation and the duty to carry out detailed cost-benefit analysis prior to the introduction of any new rules. These processes, which are a key part of the FSMA framework, reflect the fact that the power to make rules in this way is a quasi-legislative power that would normally be subject to Parliamentary oversight.

3.23 If the Government considers that such processes are required, the Government will work with the FSA and the Bank to determine whether the current FSMA mechanisms around the rule-making process need to be simplified or streamlined to support the PRA's new approach to regulation."

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

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

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

We consider that the rule-making processes of all of the future regulatory bodies should be subject to statutory processes, including consultation with a practitioner panel, wider public consultation and cost-benefit analyses. It is important that rules are made with due regard to considerations relevant to all stakeholders and participants in the financial markets. Without following the principles of natural justice in the rule-making function, there will inevitably be a perception that rules are being imposed on financial market participants without due appreciation of market practices and legitimate concerns that stakeholders may have. This is also important to ensure that the UK maintains its reputation for having a regulatory system with integrity and one that serves as an example par excellence for other national regulatory systems.

In addition, these problems will be an integral part of the new rule-making function at the EU level which militates against having looser processes at the national UK level.

We note that it has recently become evident that the requirement for cost-benefit analysis is being more widely accepted and implemented within the European Union, including for financial services regulation.

Rulemaking: reduction and simplification of rules - paragraph 3.24

Paragraph 3.24: *"The Government generally expects that, as part of its new judgement-based approach, the PRA will seek to reduce and simplify the rules and guidance contained in what is currently the FSA handbook, consistent with the need for compliance with European law and the need for transparent regulation and legal certainty.*

In general, a reduction and simplification of the FSA handbook would be welcomed provided any changes were appropriately balanced with the need for compliance with European law and the need for transparent regulation and legal certainty. However, the PRA will need to continue to implement the European prudential rules consistently, including the detailed requirements. The developing trend towards vesting more powers in the European institutions and removing powers from national regulators places importance on ensuring both the rules set by the EU regulators and the PRA generally have the same level of detail and certainty of application. Note that the PRA's ability to impose super-equivalent requirements is also likely to be circumscribed. These developments would inhibit much of the PRA's ability to reduce the amount of detailed rules.

The prudential rules, if they are reduced and simplified, would still need to provide firms with a great deal of certainty. In order to ensure no discrepancies between individual judgements made by the PRA, the PRA would need to be sufficiently resourced to ensure consistency in the application of the rules towards similar firms. This could result in an overly bureaucratic system which could be avoided by there being clear detailed rules for firms to follow.

Other examples of "reducing" and "simplifying" rulebooks (e.g. market abuse, conduct of business rulebooks) have resulted in helpful clarificatory guidance for industry being removed. Other initiatives have resulted in rules or guidance being "reclassified" in order to meet rule reduction targets (e.g. the FSA PERG rules). Simplification should be through removing duplication and better drafting, not by removing or just moving helpful guidance.

Prudential requirements cannot be reduced to the extent that they become only broad principles. In a recent discussion paper published by the FSA on trading activities,[1] the FSA pointed out that it had conducted an extensive review of the inconsistencies in the treatment of trading books by various firms during the crisis. For example, there were found to be wide discrepancies between values ascribed to similar positions at different firms, and where valuation uncertainty during stressed periods was not adequately captured. Principles-based prudential rules would not instil confidence in firms, the markets or the public. This approach to prudential regulation would therefore likely not promote financial stability.

<u>Transparency and accountability: paragraphs 3.37 to 3.40</u>

Paragraphs 3.37 to 3.39: *"3.37 In addition to being accountable within the Bank to Court, the PRA will be externally accountable to Government, Parliament, and the public. As a starting point for ensuring this accountability, the PRA will be a required to produce an annual report which the Treasury will lay before Parliament. The Government will seek to*

[1] FSA Discussion Paper: "The prudential regime for trading activities – a fundamental review" dated 25 August 2010 (DP10/4).

supplement this basic requirement with further practical accountability mechanisms which will reflect the significant public responsibilities with which the Bank is being provided.

3.38 Given the quasi-legislative rule-making function of the PRA, including the power to raise levies from firms, the Government will give particular consideration to which, if any, of the accountability mechanisms currently established with respect to the FSA should be put in place for the PRA. These mechanisms are described in more detail in paragraph 4.36.

3.39 The Government will also legislate to make the PRA subject to audit by the National Audit Office (NAO). This will deepen accountability and transparency, and NAO audit will also allow for further parliamentary scrutiny, as it will enable the NAO to investigate and produce reports on aspects of the economy, efficiency and effectiveness of the PRA's performance, which the Public Accounts Committee (PAC) will be able to scrutinise.

3.40 The Government also expects that the PRA will continue the practice adopted by the FSA whereby senior representatives agree to appear before the Treasury Select Committee as requested."

Paragraph 4.36: "*The CPMA will be subject to the following accountability mechanisms set out in statute:*

- *a requirement to produce an annual report to be laid before Parliament by the Treasury;*
- *a requirement to hold annual public meetings;*
- *a duty to establish consultative panels (outlined in more detail below);*
- *a duty to maintain a complaints mechanism similar to that required of the FSA by schedule 1 of FSMA;*
- *decisions to be subject to appeals in the Upper Tribunal, where appropriate; and*
- *reviews and inquiries (along the lines of those provided for currently in sections 12 and 14 of FSMA)."*

It is important that the PRA be subject to judicial scrutiny and an appeals procedure to the courts. FSA regulatory decisions are currently subject to appeal to the Upper Tribunal, an independent judicial body which took over the functions of the Financial Services and Markets Tribunal in April 2010. These arrangements ensure compliance with the European Services Directive[2] as well as other European legislation, which provide that any regulatory decisions by the regulator must be subject to an appeal to the courts. Consideration should be given to whether the tribunal should, going forward, be comprised only of experts. Their

2 Directive 2006/123/EC of 12 December 2006 on services in the internal market, article 10.6 provides: "Except in the case of the granting of an authorisation, any decision from the competent authorities, including refusal or withdrawal of an authorisation, shall be fully reasoned and shall be open to challenge before the courts or other instances of appeal."

main task would be to check fairness and consistency in the exercise of individual regulatory discretions. It is doubtful that recourse through judicial review would be sufficient to satisfy the requirements of EU law because of the numerous conditions that must be satisfied before an applicant can proceed to have a decision reviewed. If the PRA were not made subject to judicial scrutiny it risks non-compliance with European law. Furthermore, provided that the prudential rules that the PRA implements provide sufficient clarity to firms, there should be few instances of appeals in this area of regulation.

We would be pleased to discuss any of the above comments should you find that helpful. Please do not hesitate to contact us if you would like to do so.

We look forward to seeing your formal legislative proposals in relation to the reform of the UK's regulatory framework in due course.

Yours faithfully,

Shearman & Sterling (London) LLP

Shearman & Sterling (London) LLP

Shearman & Sterling (London) LLP Contacts:

Barney Reynolds

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Sirs,

Any reform should take heed of the need to keep the cost of any new regulatory body under control. The FSA paid no regard to it's own costs and expenditures which were heaped onto the heads of the firms it supervises.

Member firms should be able to have a say in the costs and format of regulation and to be able to veto unnecessary costs and expenditure.

Regulation should not be about firms paying for the mis-selling of others.
The PPI debacle is a case in point. PPI was mainly sold by banks and building societies. This firm deals only with the SME market advising on
employee benefits – we have never sold a PPI policy – ever. We have
however been lumbered with the compensation costs via Compensation scheme
levy to the tune of over £2000.. This cannot be right. Worse is to come
– a whole industry has now sprung up around the PPI mis-selling with huge single page advertisements asking for policy holders to come forward for their compensation – why should we pick up the tab for the misdemeanours of the Banks yet again just because we happen to be classified in the same
category as General Insurance Intermediaries.

Why is the Professional Indemnity cover of the mis-seller not made to pay by
the regulator – surely that's what PI insurance is all about.

Kind Regards Ingrid.

BforB_logo(web)1

Ingrid Skoglund B.Sc(hons)Cert PFS

Managing Director
Benefits For Business Ltd
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RESPONSE FROM THE SMALLER BUSINESSES PRACTITIONER PANEL OF THE FINANCIAL SERVICES AUTHORITY

TO

HM TREASURY CONSULTATION
A NEW APPROACH TO FINANCIAL REGULATION: JUDGEMENT, FOCUS, STABILITY

OCTOBER 2010

INTRODUCTION AND OVERVIEW

1. The Smaller Businesses Practitioner Panel (SBPP) welcomes the opportunity to respond to the HM Treasury Consultation Paper 'A New Approach To Financial Regulation'. We are particularly pleased that the importance of our Panel's work is recognised in the Treasury Consultation, with its proposal to set our Panel on the same statutory footing as the other two independent Panels in paragraph 4.38.

2. The SBPP was set up by the Financial Services Authority in recognition of the need to have a specific Panel to represent the interests of smaller firms to work alongside the statutory Practitioner Panel and Consumer Panel. More details of our role and membership are at Appendix 1.

3. The proposed changes have an impact on smaller regulated firms, with the regulation of most firms transferred to the CPMA, but a good proportion also regulated by the PRA. This consultation is therefore of direct relevance to all firms which are represented by the SBPP.

4. We are alarmed to see that there is little reference in this Consultation Paper to the likely consequences of these proposals on the smaller firms sector. This is despite the fact that smaller firms represent around 90% of all regulated firms – some 15,000 businesses, providing financial advice and other services in towns and cities throughout the UK.

5. These proposals could have a seriously adverse impact on the viability of smaller firms. We are already preparing for significant regulatory changes resulting from the Retail Distribution Review and Mortgage Market Review, as well as initiatives from Europe such as Solvency II. At the same time, the Government's wider plans to reduce the deficit are expected to lead to a

contraction of business, as likely increases in unemployment and cuts in public spending reduce consumer spending to immediate and essential purchases. Such difficult times are likely to result in increasing financial fraud, higher numbers of individuals looking to blame others for their problems, and people getting into difficulty with their mortgages etc. The result will be increased regulatory activity (and costs) with added financial strain being placed on the FOS and FSCS.

6. The added regulatory burden of creating the PRA and CPMA at a time when trading conditions will be difficult is unwelcome. Smaller firms might reasonably expect help and support from the Government to lessen the burden of bureaucracy during difficult economic times, rather than it being increased. We believe the Department for Business Innovation and Skills (BIS) should be asked to comment on the impact of this increase in regulatory requirements on smaller firms.

7. A common concern for smaller firms is the cost of regulation. The transition costs of these proposals are estimated at £50million over 3 years. Firms will be expected to pay additional fees to cover this cost, with no clear overall benefit of possibly avoiding a future financial crisis.

8. Overall, we believe that these proposals are expensive to implement, not practical to put into action at this time, and risk causing damage to the smaller firm segment of the financial services market. Smaller firms are important, as they offer an added range of service to consumers, and increase the competitiveness of the UK financial services industry. We have yet to be provided with analysis or justifiable arguments that these measures will prevent the next financial crisis.

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?

9. The Panel acknowledges that the FPC's principal concern should be financial stability. However, we agree with 2.29, that there is merit in providing a clear and transparent exposition of the factors it would be legally obliged to consider.

10. The FPC will be in a powerful position, in the fact that its views can direct the actions of the regulators for all financial firms, with little accountability in the current structure. It is crucial to have the power of challenge from an industry perspective within the FPC's decision making. We would urge that the external members of the FPC have detailed knowledge and understanding of the wider financial services industry – and this must include sectors regulated by the CPMA as well as the PRA. An illustration of the importance of this effective challenge is the decision to let Lehman Brothers fold in 2008, during the last financial crisis. The decision was made in isolation based on the assumption that Lehmans would not have a material

effect upon the retail banking sector as it was primarily a wholesale bank.. If there had been effective internal challenge of that decision the level of contagion in the banking system, and the exposure of retail banks' to Lehmans may have been highlighted. The decision may still have been made, but with a fuller knowledge of the implications and the extent of the impact than seems to have been the case.

11. It is crucial that the FPC looks at financial stability in the context of other factors that may be affected by its decisions. From a smaller firms' perspective, there is a perceived danger that an unrestrained objective relating simply to financial stability potentially focuses just on the very largest financial services firms. Although these will of course have the most significant impacts affecting stability, the knock on effects are felt by all smaller businesses and therefore must be taken into consideration.

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

12. There must be clear secondary factors to ensure that the FPC takes into consideration the impact of its decisions on the whole spectrum of the regulated community (including both the PRA and CPMA), and the consumers of financial services. We are concerned that, under the current proposals, the FPC may decide that the way that firms were operating was causing potential financial instability. This could cause the FPC to direct a regulatory change in the PRA and/or CPMA that would have a huge impact on the way that firms do business, but with no requirement to consider the wider impact of their decisions. Although we recognise that the FPC will not have the activities of small firms as its main focus, nevertheless, it must not make decisions which will unnecessarily penalise them.

13. We suggest secondary objectives for the FPC that highlight the need for proportionality and risk based regulatory scope and pay regard to the need for competition in the industry. The FPC should also take into account the diversity of size of financial services businesses, which is an important component of the current levels of competition and consumer choice in financial services.

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?

14. It is our view that, due to the potential significance of the factors to smaller financial services businesses, they should be statutory objectives rather than 'have regards'. This will help to remove any ambiguity in respect of any provisions in respect of the wider financial community.

15. We suggest that the FPC has similar secondary objectives to the PRA and CPMA to ensure coordination. It could be an adaptation of the current "have regards to" of the FSA – particularly looking at the following principles: that the burden or restriction should be proportionate to the benefits; the need to

minimise the adverse effects on competition, and the desirability of facilitating competition between those who are subject to regulation.[1]

16. With the split of regulatory authorities, there will need to be a new secondary objective for the FPC as well as the PRA and CPMA, that directs each body to have to take into account the potential impact on the other bodies' core objectives.

PRUDENTIAL REGULATION AUTHORITY (PRA)

Q4 The Government welcomes respondents' views on:

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

17. We believe that the PRA must have regard to the primary objectives of the CPMA and FPC: smaller firms who will be regulated by both the PRA and the CPMA will have additional costs and work pressures in providing separate and yet coordinated returns, information gathering, ARROW/supervisory visits. There is not, and should not be a strict dividing line within a firm's culture between its duties relating to prudential risks and conduct risks, and yet firms will have to split out these concerns for the different regulators.

18. For example, smaller firms such as Credit Unions (as a category of firms likely to be scoped by the PRA and CPMA) will have maximum interest rate levels that are driven by the prudential rules, but may also have similar tensions between conduct and prudential requirements in terms of the ability to sustain increased costs and deal with competing regulatory requirements and burdens.

19. An example of potential conflict of the requirements is in the regulation of consumer lending. It may be the case that the CPMA, in wishing to help consumers, would want lenders to be more flexible in their treatment of consumers; for example in allowing people to swap to interest-only mortgages from capital and interest mortgages when facing temporary problems with keeping up payments. However, from the prudential side, the capital provisioning required for loans that are swapped to interest-only due to difficulties, is greater than that if people applied for a new interest-only mortgage. Therefore, a smaller firm with tight capital requirement limits, may not be able to be as adaptable to consumer needs as the CPMA may want them to be, due to limitations from the PRA.

20. There is a significant potential for conflicting requirements from regulators, particularly in priorities and also in timescales for action. This must be

[1] Financial Services and Markets Act 2000 Section 2 – The Authority's general objectives.

minimised by ensuring that each of the regulators has a statutory duty to take into account the requirements of the others.

- **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;**

21. The principles for good regulation currently contained within Section 2 of FSMA must be maintained as a minimum.

22. We believe the principles should in some cases be strengthened. From a smaller firm perspective, there has to be a sense of proportionality into how firms are regulated, and so the Government must ensure that there is a balance in the regulatory approach. Although Cost Benefit Analysis may be more difficult to carry out in the prudential arena, there must be a strong pressure on the PRA to take into account proportionality and overall consequences for the different sectors and smaller firms, as set out in our answers to the further points.

- **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**

23. The requirement to have regard to the potential adverse impact of regulation on innovation or the competitiveness of the UK financial services sector must be retained. Smaller firms have a key role to play in fostering competition and consumer choice by providing niche services and business opportunities.

24. As the PRA will be part of the Bank of England, it must have a strict requirement to maintain the range of availability in the market across all sectors of financial services. An example of the need for flexibility and awareness of competitiveness is in the context of the private client asset management sector. This sector handles substantial amounts of client assets without the same level of prudential supervision as banks. A pure macro – prudential approach will result in most of these firms never being properly considered. However, the amount of assets that this sector holds is large (£335 billion according to APCIMS). The PRA must have a responsibility and ability to act flexibly in different sectors of the industry: if there was a problem in this sector, then taken together they add up to a material impact – especially as issues in the sector tend to be systemic due to common dealing, clearing and settlement systems dependencies.

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

25. Much of the justification on moving the PRA to the Bank of England in the consultation rests on the greater expertise at the Bank: 2.14 states that for central banks the ‘depth of their staff’s experience in the functioning of financial firms and markets’ gives them a competitive edge. However, this

has until now been concentrated on banking, and yet the new responsibilities of the PRA will cover a much wider spectrum of financial services companies.

26. Therefore, the PRA must have a broader public interest duty with regard to the range and diversity of the financial services industry as suggested for the CPMA (4.12). If this is not specifically stated, we believe that the tendency of the FSA to a 'one size fits all' approach, with a concentration on problems in the largest banks, is likely to be maintained and possibly increased in the PRA. This could lead to significant problems for non-bank firms, particularly smaller firms. There must be specific expertise in the PRA to be able to assess the prudential risks in the full range of smaller firm business models in all sectors under the PRA.

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?

27. We advocate one integrated system for as many aspects of the regulatory system as possible. As firms have an integrated approach to their prudential and conduct risks, it would be simpler to have a joint assessment, and should lead to more cost effective regulation to the benefit of firms and consumers alike. This is particularly the case for smaller firms.

28. We welcome the commitment (3.27) to review IT applications required by the new regulatory system "in its entirety". We urge coordination of IT systems between the PRA and CPMA to ensure technical requirements from the two authorities are synchronised and not changed unnecessarily. IT systems are typically expensive and create additional workloads for regulated firms: both in amending their own systems to enable reporting, and also in management time to resolve difficulties. The FSA's implementation of the new GABRIEL system only a few years ago was fraught with problems, and we would warn against any changes unless they are absolutely necessary. Major changes are likely to increase costs and aggravation at a difficult time for all UK financial services firms.

29. Where an integrated model is not possible, there must be close cooperation at working level, to avoid conflicting regulatory requirements and a non-level playing field developing.

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?

30. We fully support the idea of regulators applying their judgement in assessing firms, but only on the basis of clear and agreed principles. We are concerned that 1.17 states the aim to 'rebalance the operations of the prudential regulator away from rules and more towards the exercise of judgements....supporting the creation of a new regulatory culture within the

PRA', without any reference to the principles on which such judgements will be based.

31. Any judgement-based approach from the PRA (and possibly CPMA) without any agreed guidelines cannot be allowed to prevail when there are European legal structures which apply to the UK – much of it set through maximum harmonisation directives. In today's global economy, the UK cannot have a subjective and uncertain regulatory regime that could unfairly disadvantage UK firms. We suggest that any judgement based regulation particularly in the prudential arena should be set within a clear context of reference to European and international requirements.

32. In addition to the European requirements, we support the proposal to use FSMA as a basis for the future powers of the PRA. We would advocate as much similarity as possible between FSMA requirements and those of the new bodies: even minor changes to the style of regulatory requirements impose a burden, particularly on smaller firms, in ensuring adaptations are made to comply with the changes.

33. There must also be maintenance of a similar system to the current one in providing a route for firms to challenge regulatory decisions. The current Regulatory Decisions Committee, and the associated procedures are an important safeguard for firms in allowing an appeal mechanism, and a similar system must be provided in the PRA.

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

34. All the regulatory bodies must have a degree of external accountability. It is not enough for the PRA to be directed by the Bank and the FPC. There must be an opportunity for practitioners and consumer representatives to consider the wider implications of PRA rulemaking.

35. We consider the current safeguards on rule making functions in the FSA – such as consultation and the duty to carry out Cost Benefit Analysis (CBA) – should be continued in some form for the PRA. We therefore support the application of the principles set out in 3.10 as a minimum requirement of the PRA.

36. From the smaller firms' point of view, we are particularly concerned about ensuring proportionality in introducing new measures and interpreting changes to requirements from Europe. We have expressed concern in the past about the FSA's inadequate use of CBA. We would like to see more emphasis on the assessment of the costs of implementing regulatory changes to ensure that a more risk-based, judgement-focussed approach to supervision is achieved which takes full account of the impact of changes on firms, and that the benefits and risks are clearly articulated.

37. We believe that the current system of independent Panels to provide the FSA with a sounding board on the implications of regulatory changes prior to consultation is important and helps to make regulation more effective. We

therefore suggest that a similar system is maintained for both the PRA and CPMA. We provide more information on this in our answer to Q12.

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

38. We do not believe that there should be a streamlining of safeguards for prudential regulation if that means a lessening of external accountability of the demands placed on firms by the regulator.

39. Indeed, we have become sceptical in recent times over the mechanisms employed by the FSA regarding the quality and independence of CBA work and eventual findings. We regard the consultation and quality control processes in developing new regulatory requirements as an essential element of effective regulation which must be enforced within the new regime.

40. We also recommend that PRA safeguards should take EU requirements into account. It would help to lessen regulatory changes, if the principles by which the EU will be developing regulatory policy, are also core aims of the PRA. The EU objectives of delivering stable, secure and efficient financial markets and ensuring coherence and consistency between the different policy areas, such as banking, insurance, securities and investment funds, financial markets infrastructure, retail financial services and payment systems, should be adopted by the PRA.

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.

41. We are concerned that The Bank of England does not have the same external accountability mechanisms as the FSA, and yet it will be an extremely powerful force in the proposed new structure. We are particularly concerned because small firms are likely at best to be minor consideration in its discussions on prudential issues.

42. We believe that, as an organisation that will have an impact ultimately on the viability of thousands of small firms and on the livelihoods of all of its owners and employees, there must be an input to the PRA's decision making on behalf of practitioners and consumers – which should also contain a smaller firm dimension.

43. At the level of operations, with fewer smaller firms regulated by the PRA compared to the CPMA, we are concerned that the smaller firm voice may become lost within the PRA. We wish to see a specific facility created, similar to the FSA's Smaller Firms Division within the PRA, to protect and promote the interests of smaller firms.

CONSUMER PROTECTION AND MARKETS AUTHORITY (CPMA)

Q10 The Government welcomes respondents' views on:

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

44. It is essential that the objectives of the regulatory organisations are coordinated to avoid the potential of conflicting regulatory pressures being put on to firms. A significant number of firms will be regulated by both the PRA and CPMA, and so each must have regard to the objectives of the other, otherwise the firms may be left with the job of balancing competing regulatory requirements.

45. It is essential that the objectives of the regulatory bodies are coordinated. There is an additional risk that the increased number of regulators and related staffs will result in issues "falling down the cracks" between regulators – exactly what they are supposed to be trying to avoid.

46. Our understanding is that, for many smaller firms, their prudential requirements will be monitored by the CPMA, as they do not individually present a significant regulatory risk. This means that the premise that the CPMA can focus on conduct issues is misplaced. It will have prudential responsibility for firms (and, indeed, activities) under its regulatory gaze that are not otherwise prudentially regulated by the PRA. For the clients of those firms, and as an aggregated group, the supervision of prudential soundness will be important, and must be recognised within the responsibilities of the CPMA.

47. In addition, there may be significant problems where firms are regulated by both the PRA and the CPMA, and where some of their activities require prudential supervision by both authorities. Currently a firm regulated by the FSA has one prudential capital regulator, but if the CPMA's rules entail a capital requirement for an activity that is regulated by them for a firm whose other capital requirements are set by the PRA this could mean the firm will require additional capital. This may prove difficult for, for example, an insurance firm that carries risk but also sells directly to the public and is regulated under the Solvency II requirements, which is a maximum harmonisation directive. Although it is unclear at the moment, we are concerned that the CPMA might impose additional capital requirements on the insurance firm, to be calculated separately to match the requirements applied to an insurance broker undertaking similar selling activities.

- **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;**

48. We support the retention of all of the principles for good regulation currently contained within Section 2 of FSMA. We would advocate that they are strengthened in some cases, particularly in the application of Cost Benefit

Analysis (CBA). We believe that FSMA is severely compromised in its application of CBA, because it requires only costs to be quantified whereas benefits only have to be qualified. A far more robust position is necessary. This should comprise a Market Failure Analysis prior to any new rules being proposed followed by a CBA that quantifies both costs and benefits.

49. From a smaller firm perspective, our overall concern is for there to be proportionate regulation. We urge the Government to ensure that there is a balance in the regulatory approach.

50. These proposals to change the structure of regulation will bring an added burden on all firms – even those who retain only one regulator – as they may have to change systems and priorities to respond to a new regulator's requirements. We urge as much similarity as possible between the old and new systems and priorities. Since the establishment of the FSA, all financial services firms have incurred considerable expense in developing appropriate reporting systems. We would not wish to incur further expenses without good reason.

- **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**

51. The requirement to have regard to the potential adverse impact of regulation on innovation or the competitiveness of the UK financial services sector must be retained. This is not only the case for firms to be able to operate effectively overall. There is a specific aspect for smaller firms. Smaller firms have a key role to play in fostering competition and consumer choice by providing niche services and business opportunities. Unless regulators are conscious of the need to maintain the range of availability in the market across all sectors of financial services, the impact of action on smaller firms is in danger of not appearing on the regulatory radar.

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

52. We do not support the proposed "consumer champion" role for the CPMA. We believe it is inappropriate for a regulatory body to have such a label, especially in relation to smaller firms. The implications here are grave and could be detrimental to competition and innovation. A better approach would be to ensure a reasonable and fair balance between the interests of consumers and the impact of those interests on firms seeking to provide quality services to consumers.

53. We believe that smaller firms also need "champions" to ensure that they can trade successfully in support of high levels of consumer protection. We would like the regulator to have a responsibility to seek a reasonable and fair balance between the interests of consumers and the impact of those interests on firms seeking to provide quality services to consumers.

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

54. External accountability is a key part of the credibility of the regulator. We therefore fully support the transfer of FSA accountability mechanisms to the CPMA. Indeed, we would wish to see the full range of accountability mechanisms at the PRA as well.

55. It will be vitally important that the voices of practitioners – including those representing smaller businesses – are allowed to be heard in the CPMA's decision making processes, particularly if it is given a role as 'consumer champion'. We have responded in more detail to this under Q12.

56. We also would like to be reassured that appeal mechanisms for firms to challenge regulatory decisions will be maintained. We believe that the current system, including the Regulatory Decisions Committee, will need to be maintained for the CPMA.

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

57. The Panel clearly has a direct interest in this question. We are pleased with the Consultation Paper's recognition of the role the SBPP has played since its creation. All members of the SBPP work to ensure that the very different needs and requirements for the regulation of smaller firms are given a voice within the regulatory structure. We believe that this is a necessary role, and one that will continue in the future structure. It will be good to give that role its full recognition as a statutory panel in the future.

58. We believe that the current FSA framework of three independent panels should be maintained – all with a statutory basis. We believe that they should have a role to monitor and advise on the policies of both the CPMA and PRA. It may be that the Panels will need to break down some of their work into delegated sub groups to allow there to be a necessary amount of specialism in some discussions. However, there is an overall need for members of the Practitioner Panels to take an overview from the position of regulated firms, and for the Consumer Panel to be aware of all the dynamics and levers at play for the regulated community.

59. It will be important that the PRA and CPMA both have a specific duties to consult the Independent Panels on regulatory policies. The Panels must be set up as a key accountability mechanism for the regulators, to ensure the Panels can operate effectively. The Panels should also have the power to challenge both regulators on issues which impact on their constituencies. For example, the practitioner panels should both have the ability to raise issues about fee levies with both regulators. Therefore, if practitioners become concerned that there is unnecessary duplication of activity and costs across the regulators, this should be open to external challenge and justification by the PRA and CPMA.

60. As it is not possible for all sectors to be represented individually on the SBPP, members should, as now, be selected to represent broad segments of the industry. Those members must have the ability and broad knowledge to see the bigger picture and to seek to take into account the broadest interests of their sector. A significant time commitment is required from Panel members, which is difficult for those in smaller firms to commit. It is therefore vital that members are supported through a well-resourced secretariat and research facilities for all the Panels – with access to both the PRA and CPMA. Staff at both regulators should be under a strict understanding of the need to respond to Panel requests for information. The Boards of the regulators and all the senior decision makers must have a responsibility to consider and provide a response to opinions of the Panels.

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

61. We strongly support any measures which will achieve economies of scale and simplicity of access for regulated firms.

62. We support any proposals for clear and simple funding arrangements, with the CPMA as the central point for fee collection, but no cross subsidy. This should maintain transparency of approach and avoid duplication of costs, whilst also being simpler for firms to administer.

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

63. We are extremely concerned about the future funding requirements for the FSCS and the pressure that this is putting on to smaller firms across the industry. The current FSCS position is currently unsustainable, as the extension of the scheme and the use of cross subsidy never anticipated the current level of claims due to failures within the deposit-taking sector. The result is that many owners and principals in smaller firms now have to pay compensation from their own income, or pass the levies on to their clients. Of necessity the latter is the more likely due to the regulatory requirement to maintain a viable business. There is almost unlimited potential impact of FSCS on smaller firms. This makes it difficult for firms to develop their business plans and decide on appropriate fee structures, and also obtain PI cover when firms have to carry unlimited risks. And yet, without PI cover the firm is unable to operate.

64. The Panel fully supports the proposal to separate out the compensation schemes and the end of the current cross subsidy between different classes of levy payers. We encourage further development of the idea to separate out responsibilities for different sector compensation schemes. At the same time, we would also like to see the streamlining of the system in any way possible and so we also support the proposal for a single organisation (such as the FSCS) to continue to administer all compensation schemes. We believe that any new scheme should not place additional financial strains on otherwise well run and financially viable smaller firms. There must be a

ceiling, known in advance. This restructuring of regulation is an ideal opportunity to 'cap' the potential compensation liabilities of small firms.

MARKETS AND INFRASTRUCTURE

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

65. We do not have expertise on markets and infrastructure on the SBPP. However, we have an overall view that it is essential as part of the restructure that a strong markets division is created with a primary objective to promote market efficiency and integrity. The wholesale market participants and activities are different from the retail consumers and it is important that the regulation of these areas recognises this fact. On the other hand, it is also important to recognise that the difficulties in wholesale markets and defaults arising from transactions in these areas can contribute to the wider economic difficulties faced by smaller financial services firms and their consumers. Therefore, it is important that the regulation of markets is fully integrated into the overall structure.

66. It is also important to note that markets and their operations are crucial to both global and European financial activities as well as the UK economy. We are concerned that if the UK's markets regulatory framework is segmented, its overall market protection and international regulatory effectiveness would be reduced. We believe it will be much more difficult for the UK to have a strong position in European and international negotiations if the UK's nominee does not hold responsibility for all aspects of the regulation being discussed, and so has to defer to others on key aspects

67. We recognise the systemic importance of the regulation of infrastructure provision. However, we would re-iterate our concerns about wide segmentation of responsibility.

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

68. Harmonisation of the FSMA regime in this area may well require increased overall regulatory cost, as the Part 4 regime is direct authorisation. There is no detail available to outline the likely regulatory benefit or to provide an indication of the impact for the smaller firms (if any) and so it is difficult for us to comment on this point. However, as noted in the point above, changes in these areas can contribute to increased costs in the wider market, which can ultimately affect smaller financial services firms and their consumers. There may also be wider costs associated with this in the form of secondary legislation reviews.

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.

69. We believe that strong, effective and coordinated regulation of markets must be a key part of the restructure. The regulation of the primary market needs to be linked in to the other parts of the financial market to ensure overall stability. We are therefore of the view that success of the overall primary objective would be best achieved if the functions of the UKLA were integrated into the overall markets regulation structure, and not merged with the FRC.

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.

70. We believe it is important to have coherent and coordinated regulation of financial markets. Therefore, our view is that all the current aspects of financial market regulation should remain in this financial regulation structure, and not be moved to the proposed new companies regulator.

CRISIS MANAGEMENT

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

71. Any crisis is likely to be considered a larger firm issue due to the systemic nature of crisis management as witnessed in 2008/9. However, there may well be significant fall out from any crisis management affecting smaller firms: if a major product provider collapsed, it may affect thousands of smaller firms who sold the products. It is therefore important that there is a clear system to take into consideration the impact on the wider financial community of any crisis and the actions taken to mitigate it.

72. We are concerned that, despite the responsibilities set out in Table 6.A, it is still unclear to us, who will take the responsibility for whether a major bank or insurance company is allowed to go under, or is provided with external support. The decision making processes and communication are likely to be more complex rather than simpler with the regulator being split.

73. We would also like to highlight the problem with regulators re-writing history with the benefit of hindsight in the aftermath of a crisis. For example, Lehman Brothers were considered one of the strongest covenants for issuing guarantees, and yet after their collapse, advisers who made the best possible recommendations at the time, were pursued by the regulators as

responsible for the advice. Smaller firms and advisers must not be regarded as easy targets in retrospect for operating within the known parameters of the time.

IMPACT ASSESSMENT

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

74. We are concerned that the justification of the decision to proceed with these proposals is based on the following assertion: "It is impossible to quantify the benefits of the proceed option in a realistic way…The benefits from reducing the frequency or severity of financial crises such outweigh the additional resource costs." We are not convinced that enough has been done to prove that these measures will reduce the frequency/severity of financial crises. We would like to see a more complete justification of the benefit in regulatory outcomes compared to the cost and burden of these changes, which we believe will be significant for smaller firms.

75. We disagree with the "No" answer to the small firms impact test. The justification in the consultation paper is given as: "Small firms which take deposits or effect or carry out contracts of insurance will be regulated by the PRA and CPMA. The proposed reforms are likely to have some effect on their costs. Most small firms in the financial services industry are not deposit-takers or insurers and will be regulated by the CPMA in succession to the FSA. They are not likely to be materially affected by the proposed reforms."

76. We have calculated that around 800 smaller firms will need to be regulated by both the PRA and CPMA – this includes small deposit takers, insurance firms, friendly societies and all credit unions. This is a significant number of firms who will be subject to dual regulation. It is not just the amount of the fees that will need to be borne by these small firms, it is the possibility of having to produce differently formatted information for each regulator, setting up new systems to deal with the different regulators' requirements, responding to communications and requests from regulators, and hosting separate regulator visits. For instance, in a small firm, preparation for and the hosting of a regulator's visit takes up a considerable amount of the chief executive and other senior staff time: to double those requirements will take a sizable chunk of resource away from the core business.

77. For those smaller firms which will be regulated solely by the CPMA, we remain concerned about transitional costs and potential ongoing costs. The assumption that there will be no increase in costs for those who are only regulated by the CPMA is justified in the Impact Assessment firstly because

certain rule changes will happen regardless of regulatory structure (due to Europe etc) and secondly because other rule changes will be subject to CBA. However, we have been challenging the FSA over the past few years over the effectiveness of their cost benefit analyses. We would like to register our concern that if the new CPMA is charged with becoming a consumer champion, it may feel justified in bringing in new requirements where the cost outweighs the benefits, and there will be little internal counter-argument within the regulator to say that too many of these requirements will undermine the viability of smaller firms.

78. We are also concerned that the quality of regulation at the CPMA may be diminished, particularly for those smaller firms who will have prudential regulation carried out by the CPMA. With the splitting of the regulator in two, there is a danger that the supervisors with an interest in and greater understanding of prudential issues will all move to the PRA, as that will be the place with more opportunities in prudential supervision. This could leave the prudential supervision at the CPMA as seen as being of lesser importance, and so less able to attract quality supervisors.

79. The transitional costs are expected to be “in the order of £50 million spread over about 3 years”. This is a significant additional cost in regulatory fees, and will be accompanied by internal costs at each firm as they need to amend systems and procedures to adapt to the new regulators. Any additional costs are more difficult for smaller firms to absorb.

80. We also challenge the Impact Assessment statement that the proposal will not have an impact on competition. We believe that there is a very real danger of an adverse impact on competition from these proposals. Smaller firms are in danger of going out of business with new regulatory structures and requirements being put into place in 2012, just when firms are having to cope with wider changes in regulatory requirements arising from the Retail Distribution Review, the Mortgage Market Review and Solvency II. Smaller firms are key contributors to the diversity and competitiveness of the financial services marketplace in the UK.

APPENDIX 1

ROLE AND REMIT OF THE SMALLER BUSINESSES PRACTITIONER PANEL

1. The Smaller Businesses Practitioner Panel (SBPP) was set up by the Financial Services Authority (FSA) to represent the views and interests of smaller regulated firms and to provide advice to the FSA on its policies and strategic development of financial services regulation.

2. Our members are drawn from smaller firms operating across the main sectors of regulated business.

3. We consider several factors when deciding on the definition of "smaller" businesses and take a flexible approach to the application of criteria. A firm may have – in relative terms – a minor market share or small number of employees in the context of its industry sector. In addition, the firm's financial position and whether the firm is owner-managed may be relevant.

4. We work to ensure that the interests of smaller financial services firms are taken into account and their importance to a healthy, successful and vibrant marketplace are properly reflected in the policies of the FSA.

5. The names of the members of the SBPP as at 18th October 2010 are as follows.

Panel Member	*Position*
Simon Bolam *(Acting Chairman)*	Principal, EH Ranson and Company
Guy Matthews *(Appointed Chairman from 1.11.10)*	Chief Executive, Sarasin Investment Funds
Clinton Askew	Director, Citywide Financial Partners
Ian Dickinson	Director, Brunsdon LLP
Paul Etheridge	Chairman, The Prestwood Group
Peter Evans	Chief Executive, Police Credit Union
Sally Laker	Managing Director, Mortgage Intelligence
Fiona McBain	Chief Executive, Scottish Friendly Assurance
Keith Morris	Chairman and Chief Executive,Sabre Insurance
Andy Smith	Special Projects Advisor, TD Waterhouse UK
Andrew Turberville Smith	Chief Operating Officer and Finance Director, Weatherbys Bank Ltd

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12 October 2010

Dear Sirs

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

The Solicitors Regulation Authority (SRA) was established in January 2007 as the independent regulatory body of the Law Society of England and Wales. We set standards for, and regulate, more than 100,000 solicitors, and 10,000 law firms, in England and Wales.

Approximately 80 law firms regulated by the SRA are also authorised by the FSA to carry on mainstream regulated activities.

Other law firms are not authorised by the FSA and rely instead on the Part XX exemption in the Financial Services and Markets Act 2000 to carry on exempt regulated activities as part of their practice. This enables them to carry on incidental services such as arranging after the event insurance for personal injury clients or to arrange for the sale of shares in probate matters. Such firms must comply with the Solicitors' Financial Services (Scope) Rues 2001 and the Solicitors' Financial Services (Conduct of Business) Rules 2001 when they carry on exempt regulated activities.

The Solicitors' Code of Conduct 2007 ("the Code", available online at www.sra.org.uk) is the ethical framework for solicitors and others regulated by the SRA. It contains provisions which apply to these various arrangements. For example, there are duties in the Code such that solicitors, and others who are regulated by the SRA, must refer clients needing an endowment policy or similar life insurance with an investment element to an independent intermediary authorised to give investment advice. Our rule requirements, and the core duties imposed on solicitors in rule 1 of the Code, are drafted in the public interest to ensure, for example, that solicitors act in the individual client's best interests and in such a manner that their independence and integrity are not compromised.

We are currently working on a programme of reform which will result in the introduction of a new Handbook of regulatory requirements to accommodate Alternative Business Structures and to support outcomes-focused regulation. This Handbook will be introduced in October 2011. It will include a new SRA Code of Conduct to replace the Code and a specialist section which will include the re-styled SRA Financial Services (Scope) Rules 2001 and the SRA Financial Services (Conduct of Business) Rules 2001.

We welcome the opportunity to consider your consultation, "A new approach to financial regulation: judgement, focus and stability". As the consultation sets out the high level principles which will determine government policy and focuses on prudential changes in this area, and does not mention the Part XX exemption, we do not intend to answer your specific questions. Instead, we would like to make the following points and observations:

- In general terms, the SRA welcomes the increased focus on consumer protection which is intended with the introduction of the Consumer Protection and Markets Authority (CPMA);

- Whilst there is no mention of the Part XX exemption in this Consultation, we would suggest that this exemption for professional firms should continue. Most professional firms rely on this to carry out exempt regulated activities for their clients. This is at low, or no, risk to the clients who receive the benefit of services provided by properly regulated firms, and in circumstances where the systems of supervision are effective, and with complaints handling and redress mechanisms in place;

- We believe that it would be sensible for the OFT's consumer credit functions to be transferred to the CPMA.

We hope that these comments are helpful; please do not hesitate to contact us if you think it would be useful to your policy development work to discuss the Part XX exemption with us.

Yours faithfully

T. J. Calvert

Tracey Calvert
Policy Executive

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Response to Cm7874
A new approach to financial regulation
From Clare Spottiswoode[1]:

Summary

The consultation paper does not ask for responses about the role of the proposed regulators, or of what their primary duties should be.

This submission argues that (a) the Consumer Protection and the Markets Authority (CPMA) should be given the primary duty of promoting competition, and (b) the Prudential Regulator should be given the primary duty of ensuring all firms can fail without causing significant harm and without imposing costs on taxpayers.

These duties would transform the financial sector, making it more efficient and, given its importance to the UK economy, improve growth, provide greater stability, and also protect consumers.

Keeping the duties as they currently stand would (a) continue the incentives for banks and other firms in the financial sector to take excessive risk and (b) maintain the existence of distortions in the sector which sap growth and ensure customers are treated unfairly – regardless of how effective regulation is.

Introduction

Given that we have just experienced the most significant financial crisis for many decades, a discussion of what these duties should be is surely important.

As the Future of Banking Commission Report said, "Banking is a structurally flawed industry that has failed its customers, its investors, and the taxpayers who stand behind it"[2]. The report made

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1 Individual, Member of the Future of Banking Commission and of the Independent Commission on Banking. Views expressed are entirely my own, and should not be taken as an indication of the views of either of the Commissions unless expressly indicated.

[2] Future of Banking Report, Foreword

clear that the problems exposed were there before the crisis, and were a contributor to it.

Implications from crisis for Prudential Regulation

The Government guarantee supporting banks is explicit in the allowance the ratings agencies make for the value of the guarantee. This means that taxpayers are providing a subsidy to the banking sector and it is not clear why this implicit subsidy should exist. As Mervyn King said "our ability to sustain a large financial centre .. depends on demonstrating .. that that centre does not depend on taxpayer guarantees, because if it does we will have to reduce the size of it to a level proportionate to our ability to provide tax finance to underpin it"[3].

When Banks have high leverage, equity becomes less relevant, and the constraint on risk-taking comes mainly from creditors. If creditors believe that there is a guarantee which means that the Government will support a bank in a way that means that creditors remain whole regardless of the risks the bank takes, then creditors have no incentive to constrain those risks. This distorts the costs of capital for banks, preventing the constraints markets provide from operating in the sector.

As Andrew Haldane noted "There are natural incentives within the financial system to generate tail risk and to avoid regulatory control .. [Banks] do so safe in the knowledge that the state will assume some of this risk if it materialises."[4]

The current system of regulation is clearly not stable, and there is nothing in the proposals that fundamentally addresses or changes this situation.

It is crucial that prudential regulation brings to bear the rigour of market pressure which regulators can never effectively imitate.

As Mervyn King said, using the example of Citibank, "We would have chosen them to be the best team that you could have to run a bank. .. Then the building was full of regulators, there were people living

[3] Future of Banking Report, p17
[4] Future of Banking Report, p51

there, dozens of them regulating Citibank. .. None of these people managed to stop the risk materialising or things going wrong. Now I cannot believe that any regulator around he world could honestly pretend that they would do better than what happened here."[5]

"This suggests that simply strengthening the role of the regulator is unlikely to create a stable financial system"[6].

The new rules on leverage ratios and capital adequacy do increase safety margins, but are not enough to create a healthy industry. The new standards do nothing to change the basic incentives to expand the business of banks as much as they can get away with, economising on equity. These pressures will find a way into the system through the weakest link, perhaps through the shadow banking system or using international regulatory arbitrage.

This means that the Prudential Regulator should not be concentrating on micro-level supervision, which concentrates on the symptoms, but rather looking at the causes of the misaligned incentives which stop market forces from operating.

Firms insulated from failure are immune from market discipline. Regulatory oversight can never be as effective or as efficient as these market pressures.

The conclusion is that the Prudential regulator's key objective should be to ensure that all firms can fail without causing significant harm to vital banking services and without threatening the wider economy, and without requiring taxpayer subsidy.

There are lessons to be learnt from the Health and Safety Executive which transformed its role from supervision to principle- based regulation some years ago. It places the responsibility firmly on the board and senior management. If safety is found wanting through inadequate actions companies and individuals can be prosecuted, fined, and in extremis sent to jail.

There has been a transformation of board culture, particularly in companies where safety is essential given the nature of their

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[5] Future of Banking Report, p18
[6] Future of Banking Report, p18

business: instead of relying on the regulator setting safety standards, companies set their own, take responsibility for those standards, and ensure that the safety culture is embedded from the top of the organisation to people who operate on the ground.

In healthcare companies, boards no longer look to the HSE to set those standards, but only to challenge, for example the company's safety case. The relationship is one of partnership. The regulator is there to set principles, not rules, and to enforce the principles. It is acknowledged that however intrusive supervision were to be, this will always be far less effective than if the board and management embed safety culture throughout their organisations. From my experience on the Boards of three safety- critical companies, that is exactly what we do, and I am proud of the way we take these duties seriously in each of those companies.

There are also lessons to be learnt from the Utility sectors where the services, just as in banking, are essential to individuals and companies and the economy.

In these circumstances it was understood that it was essential to introduce a supplier of last resort regime which would allow the regulator to take over the company as it failed and ensure that essential services would continue to be provided and customers would be transferred smoothly to a new supplier. A significant proportion of the 1996 Gas Act, which enabled competition to be introduced in the gas industry, was dedicated to ensuring that a supplier of last resort regime was in place.

Since the banking sector is also essential for the economy, a key role of the Prudential Regulator should be to ensure that these services have a supplier of last resort regime in place. It is not clear if the current Living Will proposals do this adequately.

Taking the HSE approach, the Living Will would be the responsibility of the company. This would detail what would happen if at any time a company were to be close to failure. This would set out how all its services would continue to be delivered and how the prudential regulator would take over these tasks (and enable it to allocate the activities to third parties). The regulator would challenge this Living Will, but not approve it.

The Living Will would need to set out counter party positions, the hierarchy of creditors, and how the incompatibility of international resolution regimes would be resolved. If, despite all this detail (which would require significant investment in IT and improvements in data), the Prudential Regulator felt that there was a significant risk that taxpayers would still have to support the company[7], the Regulator would have the power to withdraw the Firm's licence to operate. The Firm would be required at that point to find ways to create a more credible Living Will, perhaps through creating subsidiaries which would be firewalled if there was a liquidation, or full scale separation. This puts the responsibility for showing that the firm is not dependent on taxpayer subsidy firmly where it belongs, with the board and senior management.

A key protection for taxpayers would be the assurance that creditors would take losses, and not taxpayers.

[Clare – I have moved this paragraph further down to the next section, as I think that it may fit better there]

Since the usual outcome from a failed bank is that its business is distributed amongst the solvent survivors, there has been a tendency for concentration to increase. The Prudential Regulator needs to have a clear objective to promote competition when fulfilling its duties, i.e. the Regulator's actions should take into account the promotion of competitive outcomes, and not just concentrate on ensuring the continued operation of non-competitive financial institutions.

Implications from crisis for CPMA objectives

The current duties have been translated by the FSA as putting competitiveness above competition as its objective. Adair Turner said "I've always believed that there is a doubt as to whether [the duty to have regard to 'the international character of financial services and markets, and the desirability of maintaining the competitive position of the UK'] should be there. I'm not at all sure

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[7] that is to say that the firm would not be able to fail without causing significant loss to the general economy, and the Government would be likely to decide that it could not afford to let the firm fail

that a regulator should have regard to the competitiveness .. I think that can in a subtle way create a conflict of interest."[8]

The best way of protecting consumers is through vigorous competitive markets. By having a duty to consider competitiveness, rather than an explicit duty to promote competition, the regulator neglects using the most effective tool available to it: competitive markets have natural benefits for the economy, ensuring better run firms and better service to consumers.

The current financial market shows very significant distortions. It is highly concentrated, products are offered which garner excess profits for firms and cross-subsidies persist. The Government guarantee is itself a distortion, on which Ratings Agencies currently place significant value, which reduces the cost of risk and encourages leverage and risk taking. As long as the markets and rating agencies continue to price in the value of this guarantee, it is clear that there is a subsidy from taxpayers to the banking sector which should be removed.

None of these features would survive in a market which was effectively competitive and where firms are allowed to fail. All of these features disadvantage consumers and encourage products and sales efforts that are not good for customers, and are also not good for the economy. Such distortions increase the instability of the sector, and impose very significant costs on the economy, which is a drag on the vibrancy of growth in the real economy.

The FSA is clear that 'it does not consider pro-competitive measures to fall into its remit. Instead, these are matters for the OFT and the Competition Commission. Likewise the OFT, in its evidence to the Commission, made clear that it considers regulation of banking markets to be a limited part of its function[9]. Indeed Philip Collins of the OFT said "At the moment, we feel that the right thing to do is to actually monitor the markets, see the extent to which these changes bring about a fundamental reassessment by the banks about the way they behave and the way they treat their customers and the products they offer them.[10]"

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[8] Future of Banking Report, p53
[9] Future of Banking Report, p46
[10] Future of Banking Report, p46

Given that the financial sector is so important to all of us and to the economy, it is strange that it does not have a regulator with an objective to promote competition, as the energy regulators have. The advantage for a regulator with this power is that licence terms can be used to pro-actively deal with abuses, with conflicts of interest, with barriers to entry and anything which gets in the way of effective competition - before they become problems, and/or as they become evident.

This is in stark contrast to the way the current regime works in finance. The OFT / Competition Commission regime is very slow, only takes action after evidence of abuse is overwhelming, and only tackles a small sub-set of the evident problems.

Giving the CPMA the primary duty to promote competition would promote market efficiency, integrity and confidence and reduce the risk of instability. Such a duty would be a significant aid to the UK real economy and to growth and have the by-product of protecting customers in the most effective way possible.

Peter Sands
Group Chief Executive

18 October 2010

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

Dear George

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

Standard Chartered Bank welcomes HM Treasury's paper on the reform of the UK financial regulatory system („the Paper') and fully supports efforts to strengthen the resilience of the banking system. In particular, an increased focus on macro prudential risks by UK regulators is both necessary and appropriate to help ensure financial (and thereby economic) stability, though as the Paper recognises the return to a fragmented regulatory model throws-up challenging practicalities.

Our responses to the questions posed in the Paper are set out in the attached Appendix. These should be considered against a number of overarching observations. Firstly, regulation imposes costs that are ultimately shouldered by consumers and if disproportionate, will reduce economic growth. Additionally, unless the objectives of the new regulatory bodies require them to promote growth - as well as stability – they will act as a drag on UK prosperity and competiveness. The Government should also compel the new agencies to be restrained by an overriding principle that they discharge their duties efficiently and effectively – and that any requirements they impose on industry are proportionate to the intended outcome.

The move from a single regulator to multiple agencies creates jurisdictional uncertainty and the potential for wasteful duplication. So the boundaries between the various agencies must be clearly established and incentives hard-wired into the legislation requiring them to co-operate and routinely engage in day-to-day communication with one another. Similarly where UK regulators supervise internationally active banks they must be required to take into account the work of overseas regulators to promote international consistency and minimise duplication.

Where new policy is being developed the regulatory bodies should be required to cooperate with and, where appropriate, lead international fora; although once the standards have been agreed the legislation should prohibit unnecessary gold-plating. For UK-based internationally active banks, careful consideration needs to be given to which of the new UK regulators should lead when dealing with offshore regulators.

Whilst it is clearly necessary for the PRA to view prudential issues on a global / consolidated basis, the CPMA's jurisdiction on conduct issues should generally be restricted to the UK.

We do not support the UKLA being merged with the FRC; it would be far more sensible for it to be retained within the CPMA where it would benefit from natural synergies with the CPMA's market monitoring function.

The current proposals for accountability for the new bodies are weak and should be buttressed e.g. with more frequent ministerial oversight. Finally, arrangements and incentives must be implemented to ensure that the regulators remain focused throughout the transition to the new regulatory architecture.

Standard Chartered Bank remains highly supportive of the efforts to strengthen the financial system and we look forward to continuing to assist in the process of reform.

Yours sincerely

Peter Sands

Appendix: responses to consultation paper 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?

1. The FPC should have a clear and unambiguous paramount objective: to enhance, protect and maintain the stability of the UK financial system.

2. Whilst the FPC should have operational independence to achieve that objective, it would also be helpful to state that in order to achieve that objective it must, as a minimum, proactively identify, address and mitigate aggregate risks, vulnerabilities and imbalances. We do not believe that such a requirement would fetter the FPC's discretion in achieving its paramount goal of stable financial growth; rather it would help clarify and codify public expectations as to the type of risks that the FPC should, as a minimum, be addressing. This should not stop it from addressing systemic risks that might be posed by an individual institution. Indeed we note that the Government proposes to give the PRA a right to veto action which might be taken by the CPMA which "could cause a firm specific financial stability risk".

3. It should be borne in mind that one of the FSA's statutory objectives required it to "maintain confidence in the financial system". However, the fact that FSMA did not (until recently) specifically reference the management of aggregate risks may have contributed, in practice, to the FSA's pre-crisis tendency to focus on micro prudential regulation.

4. The FPC's paramount objective of financial stability should be supplemented with a secondary objective: macroeconomic growth. The FPC should take into account the contribution that banks make to the prosperity of society; in their role as financial intermediaries banks facilitate and catalyse growth of the „real economy'. For example, when considering whether to dampen the credit cycle and/or deflate perceived asset price bubbles, the FPC should also attempt to maintain economic growth. To do otherwise would likely result in an overly cautious approach which would unnecessarily drive down UK growth and prosperity.

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

5. The FPC should be not be "unconstrained" in its actions and should be subjected to appropriate checks and balances. The current accountability proposals are insufficient. This raises particular concerns given the proposed concentration of power within a single institution (the Bank). Other than in times of crisis, Ministerial involvement is limited to a six-monthly meeting between the Chancellor and the Governor, after which the Chancellor may comment; likewise accountability for the FPC to Parliament will be discharged through the Treasury laying a report once every six months on behalf of the FPC.

6. As a starting point the measures of accountability currently applied to the FSA and the Monetary Policy Committee should be reviewed to determine their suitability for the FPC.

Given that the Government is proposing to move even further away from a box-ticking regulatory regime to one involving judgements, making judgements on those judgments will require a robust, well resourced and transparent accountability regime.

7. There are a number of factors that the FPC should have regard to when discharging its functions. Although it may not be appropriate to apply the full suite of current FSA Principles of Good Regulation, there are some which should be applied to the FPC, and supplemented with additional principles:

- **Proportionality**: decisions taken by the FPC that impacts industry should be proportionate to the benefits that are expected to result from those restrictions. In particular, when making judgments the FPC must conduct cost benefit analysis (CBA) and only impose requirements where the evidence demonstrates that the benefits outweigh the costs. Where possible the other "have-regard" factors that follow should be fed into the CBA.

- **Innovation**: we recognise the Government's concerns that this consideration may have been given undue weight by the FSA. However, this does not justify jettisoning it completely as a consideration – rather the PRA should be reminded it is one of a number of factors to be considered and weighted by the PRA within the judgement based regulatory regime.

- **Competition:** The FPC should take into account the impact of its decisions on competition – between firms operating within the UK as well as between UK and non-UK businesses. For example, ensuring a level playing field for bank and non-bank lending is essential. It would be self-defeating if non-bank lenders were treated under a less onerous regime as preferential treatment would lead to leakage from the regulated sector and thereby undermine macro prudential regulation. The FPC should also take into account the international aspects of financial business and the competitive position of the UK. This should include contrasting the UK regulatory environment with those in competing jurisdictions and co-operating with overseas regulators, both to agree international standards and to monitor global firms and markets effectively. FPC should minimise the adverse effects on competition that may arise from its activities and facilitate competition between UK firms.

- **International coordination and representation:** macro prudential measures should be coordinated internationally to ensure a level playing field and to avoid the potential for regulatory arbitrage. The FPC should be required and empowered to engage with, and where appropriate lead, international fora dealing with financial stability risks/issues.

- **National coordination:** FPC should coordinate its actions with monetary and fiscal policy decision being made by the Bank's Monetary Policy Committee and the Government. The FPC should be staffed by appropriately experienced and skilled regulators and central bankers.

- **Data protection/confidentiality:** Memoranda of Understanding (MoUs) should be established between the various UK bodies and between relevant EU bodies (e.g. European Securities and markets Authority (ESMA), European Banking Authority (EBA) and other regulators) to ensure that information can be shared – but only where necessary, relevant and appropriate - and where it is shared confidentiality is fearlessly protected e.g. by, inter alia, providing criminal enforcement powers for information leaks.

8. Commercially sensitive information provided to regulators must be subject to strict non disclosure agreements and where the information is shared between regulators it should only be transferred where the confidentiality of the information can be preserved.

9. We commend the Government for recognising that additional capital requirements, are not the solution to macro prudential risks e.g. asset price bubbles. We encourage the Government to continue to work with international fora (e.g. Bank for International Settlements (BIS)) to explore the full range of tools available to promote financial stability. In particular, the Government should ensure that the residential housing market is not distorted by preferential tax treatment. And it should consider more creative and effective ways of addressing accumulations of risk in the financial system, including mechanisms to control activities ex-ante such as loan-to-value (LTV) caps or maximum income multipliers. In addition to regulatory measures it is important governments take measures to ensure interest rate policies and fiscal policies reduce the likelihood of asset bubbles forming. Any measures which either disincentivise or tax systemic risk must use transparent, objective, sound and appropriately calibrated models, which should attempt to quantify their costs and benefits.

10. Careful consideration should be given to the FPC's jurisdiction. Clearly an EU firm that is „passporting' into the UK could lend on significant levels thereby inflating asset price bubbles in the UK. There may be constraints on the FPC's ability to apply capital surcharges to such a firm and LTV caps are more likely to be effective.

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?

11. Yes, the factors that we have indicated above should be formulated in legislation. As indicated, we think an overriding objective should be established supplemented by a secondary growth objective and additional requirements/considerations.

12. We encourage the Government to consider carefully what aspects of the legislation should be covered by secondary legislation thereby providing a more convenient and flexible process to update and amend as financial markets innovate and develop. However, this route should only be followed where there is a requirement to consult publicly on the secondary legislation – providing opportunity for those impacted by the measures to input. The importance of this can be seen in respect of the Government's proposals to set out macro prudential tools available to the FPC in secondary legislation. Whilst we understand the need for flexibility the primary legislation should include a requirement to publicly consult when the secondary legislation is creating/amending these tools; although we recognise that may be constrained where EU legislation is enacted.

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;***

13. It would be sensible for all three bodies to have regard to each other's objectives. More importantly, where there are areas of overlap or mutual interest the bodies should work together and establish policies and procedures to ensure they collaborate and minimise unnecessary duplication and equally to avoid the risk of underlap.

14. As regards the PRA's stated objective "to promote the stable and prudent operation of the financial system through the effective regulation of financial firms, in a way which minimises the disruption caused by any firms which do fail", perhaps there should be more of a focus on prevention of firm failure through adequate supervision (albeit we recognise that the PRA should not attempt to operate a „zero failure' regime).

- ***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;***

15. We think that principles of regulation should be retained albeit reviewed and modified in light of experience and the financial crisis e.g. efficiency, economy and effectiveness: the need to use its resources in the most efficient and economic way. Given that the Government is proposing that the National Audit Office (NAO) will audit the PRA for, inter alia, efficiency, economy and effectiveness this principle would appear to be implicitly accepted. All reasonable efforts should be made to ensure that duplication between regulators is minimised e.g. regulatory reporting could be channelled through one of the regulators and to the extent that multiple reporting is required the regulators should be required to employ standardised reporting templates.

16. Like the FPC we also think the PRA should be subjected to a principle of proportionality: decisions taken by the PRA that impact industry should be proportionate to the benefits that are expected to result from those restrictions. In particular, when making judgments the PRA must conduct cost benefit analysis (CBA) and only impose requirements where the evidence demonstrates that the benefits outweigh the costs.

- ***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***

17. Similar to the FPC, the PRA should also take into account the principles of competition and innovation (see back to our response to question two for elaboration).

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

18. Yes, the PRA should also take into account broader public interest considerations. In particular, the Government needs to take into account the contribution that banks make to economic growth. So we suggest that that similar to the FPC, the PRA should take into account the following principles: long-term macroeconomic growth; and data protection/confidentiality (see back to our response to question two for elaboration).

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?

19. The Government should conduct a thorough analysis to identify all areas where it may be appropriate for one body to oversee the discharge of overlapping/similar responsibilities. This would be consistent with the EU's Better Regulation Agenda and the principles of efficiency and effectiveness.

20. For example, the legislation should provide processes for the CPMA to delegate responsibilities to the PRA where appropriate e.g. for internationally active banks where the CPMA's jurisdiction on conduct issues would be limited. In such cases it may be more efficient and effective for the PRA to regulate both prudential and conduct issues. There is precedent for the delegation of responsibilities in the current regulatory framework; the FSA delegated responsibility (in particular Principle 6) to the Banking Code Standards Board and ensured the Board enforced basic standards (through e.g. a Memorandum of Understanding and an annual report).

21. For firms with dedicated supervisory teams, the legislation should require the appointment of a lead relationship manager within the PRA or CPMA. In addition, there should be a single data gathering point / organisation. The FSA currently uses GABRIEL (GAthering Better Regulatory Information Electronically, an online regulatory reporting system, for the collection, validation and storage of regulatory data) and this should be adapted to be uses as the single information platform to be shared by PRA and CPMA.

22. Basic administrative functions (e.g. fee calculation and collection) would appear to be amenable to being conducted by one of the bodies only. Given that it is proposed that the CPMA will be a single regulator for conduct issues all financial firms would fall within its perimeter - and those firms regulated by the PRA would form a sub set. Consequently, consideration should be given to the CPMA conducting/discharging shared administrative functions. This could include a single authorisation/approval process for both firms and Approved Persons (including those conducting Significant Influence Functions).

23. It may be appropriate for the CPMA and the PRA to draw up a joint handbook, especially considering that CPMA will be the single conduct regulator but prudential regulation will be split between the CPMA and the PRA.

24. In 2006 the Office of Fair Trading (OFT) and FSA jointly published Delivering better regulatory outcomes1 which examined the need for closer working between those regulators. Although published in 2006 there are a number of conclusions/lessons to be drawn from that exercise and we urge the Government to consider those carefully. For example, drawing on those experiences there appears to be a strong prima facie case for CPMA and PRA to share IT systems.

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?

25. We think that FSMA could provide a useful starting point in acting as a template for the legal framework governing the operation of the PRA and CPMA. Clearly the government will need to conduct a line by line examination of FSMA to help determine which sections apply to which new regulatory body and what amendments are required. We intend to review the output of that process when the Government consults on draft legislation in early 2011.

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

26. It is essential that the legislation compels the PRA or CPMA to follow a transparent and open consultation process whenever they create or modify their rules. Before making a rule change the relevant body should conduct Market Failure Analysis (MFA) to determine that there is an issue requiring intervention. That should be followed by CBA to ensure that proposed solutions are proportionate. Industry/public consultation should then follow. The regulators should only derogate from that process in times of emergency and in those circumstances consultation should follow the emergency action.

27. The legislation should also provide for sufficient and appropriate checks and balances on the exercise of the rules (once they have been made). For example there must be rights of appeal available to firms.

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

28. The Government should not streamline the current consultation processes employed by the FSA. The process of engaging in full and transparent consultation enables regulatory bodies to collect the evidence they need to make informed decisions. Unless the PRA fully consults, it will inevitably result in poor quality rule making with serious unintended consequences. The current processes meet the procedural fairness requirements we set out above and we believe are fit for purpose; and we urge the government to retain them.

29. In considering where and what consultation is appropriate the Government should have due regard to its own Code of Practice on Consultation[2] so for example consultations should

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[1] http://www.fsa.gov.uk/pubs/other/OFT_FSA_Actionplan.pdf
[2] http://www.berr.gov.uk/files/file47158.pdf

normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible. One exception to this is where a regulator is implementing an EU Directive, in which case full consultation would not be appropriate given the lack of implementation discretion.

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.

30. The PRA must have robust and transparent governance structures, policies and procedures in place which deliver accountability to the Government and all interested stakeholders including the public. The proposals set out in Paper (board and management structures; annual report to Parliament; NAO audit; PAC scrutiny) would in principle seem to meet these requirements. However, we reserve comment until we see the detail in the draft legislative proposals in 2011.

Consumer protection and markets authority (CPMA)

Q10 The Government welcomes respondents' views on:

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

31. A requirement that all three regulatory bodies (PRA, FPC and CPMA) should have regard to one another's objectives would seem sensible given that decisions made by one body may impact the objectives of another. However, the Government should go further and legislate to establish a hierarchy of authority which clearly sets out which agency is in charge where their jurisdictions overlap. This was one of the defects of the pre-crisis tripartite system. The agencies should also be compelled to work together operationally to ensure that unintended consequences of their decisions are identified, assessed and taken into account; and to ensure that duplication of regulatory burdens on firms is minimised.

32. One example of potential overlap between the CPMA and the PRA is when conduct issues are deemed to have prudential consequences. E.g. large-scale systematic miss-selling might undermine the solvency of a bank. Careful consideration is required to determint at what point (in both substance and process) does the PRA intervene in conduct issues. For large internationally active banks the PRA should be the lead UK regulator as prudential issues will generally outweigh conduct issues. The boundaries between the various agencies must be clearly established but MOU and protocols established requiring them to co-operate and routinely engage in day-to-day communication with one another.

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

33. We advocate the retention of the principles of good regulation for both the CPMA and the PRA (see back to our responses to questions 2 and 4).

- ***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***

34. Yes, please see our responses to questions 2 and 4 which, as regards competiveness, also apply to CPMA.

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

35. Consistent with our response to question four, the CPMA should also take into account the following: macroeconomic growth; and data protection/confidentiality requirements. (Please see back to our response to question four for elaboration).

CPMA's jurisdiction

36. One important issue that should be considered is the territorial application of CPMA's conduct of business rules to the activities of UK banks operations outside of the EEA. We are strongly of the view that CPMA's conduct remit should be restricted to business that is conducted in or into the UK, or in compliance with the Markets in Financial Instruments Directive (MiFID) and other relevant EU Directives, where a UK branch operates in a EU state. This is because:

(a) Business conducted outside of the UK should be conducted in accordance with the local conduct rules. It would generally be improper for the UK to force its conduct rules into another jurisdiction. Of course where member states have consented to share a common set of conduct rules (such as MiFID in the EU) then those should be applied accordingly.

(b) Outside of the EU there is no globally accepted conduct rulebook. Macro prudential rules are subject to global harmonisation through bodies such as the Basel Committee on Banking Supervision (BCBS). However, conduct rules are not subject to such a global harmonising force and so non EU states have their own conduct rules, which ought to be respected.

37. The exception to this would be where a conduct issue arose outside of the UK was such as to lead the CPMA to conclude that the behaviour was being repeated in the UK e.g. where the non-UK behaviour appeared to be reflection of a systematic firm-wide failing. We recognise that additional thought needs to be given to the remit of the Markets unit of the CPMA, particularly in relation to market conduct issues for internationally active firms.

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

38. We welcome the Government's proposals that when rule making the CPMA will be required to consult publicly and conduct MFA and CBA.

39. Additionally, we reiterate our comments set out in response to question 9 (above) in relation to the need to have robust and transparent governance structures, policies and procedures.

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

40. We agree that all three panels should be on a statutory footing and so welcome the Government's proposals to give the Small Business Practitioner Panel statutory backing. The role and functioning of the Panels should be reviewed and refreshed as part of the larger review.

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.

41. As indicated in our response to question 5, we think that the CPMA should be the fee and levy collecting body for all relevant bodies and ask the Government to conduct a thorough analysis to identify all areas where it may be appropriate for one body to oversee the discharge of overlapping/similar responsibilities.

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

42. During the financial crisis the public was uncertain regarding the amount of compensation that would be payable by the FSCS in the event of a bank failure. This contributed to confusion and in some cases panic. Subsequently the Government rightly simplified the scheme.

43. One lesson from the crisis is that any compensation scheme must be capable of being simply and quickly understood by the general public. So a single compensation scheme should be established across all financial firms with a payout ceiling and payout timeline that can be immediately understood by the public.

44. Consequently, the Government should not empower the PRA and CPMA to set their own compensation rules/schemes, as is identified as one proposal in the Paper. In times of crisis (when the scheme is most likely to be activated) the public are unlikely to be willing and/or able to differentiate between schemes and/or between organisations regulated by the PRA/CPMA. This might contribute to the panic and the mass withdrawal of deposits.

45. There should also be effective crisis communication plans in place between the PRA, CPMA, FPC, FSCS and the Government to ensure that in the event of future problems there is a coordinated and reassuring response – and this is appropriately communicated to and perceived by the public.

46. We also urge the Government to consider links here with EU developments regarding depositor protection and ensure that their plans are sufficiently flexible to accommodate any EU developments.

Markets and infrastructure

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

47. Central counterparties (CCPs) are increasingly becoming the largest concentration of counterparty credit risk in the financial system and hence arguably pose the largest systemic risk. This trend will only accelerate given forthcoming legislative changes that will force OTC derivatives to be centrally cleared. Consequently regulators primary concern with CCPs should be that they are prudentially sound. Given that the Bank will be managing prudential regulation under the new regime, the Government's proposal to transfer supervision of CCPs to the Bank is sensible and we support that. However, the Paper suggests that CCP supervision would be conducted by the payments and settlements team within the Bank. Given that the Banks supervisory prudential expertise would sit within the PRA it would seem that the PRA would be the most appropriate body to supervise CCPs.

48. From a regulatory perspective, the primary concern with exchanges is that they are operated fairly and so the conduct regulator (CPMA) is the appropriate regulator. We encourage the Government to engage in international debates that are occurring regarding the regulation of markets and infrastructure; to work towards an internationally consistent approach e.g. with mutual recognition.

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

49. Traditionally markets infrastructure has been treated differently partly on the basis that much of the front-line regulation was conducted internally. There do not appear to have been any significant problems with this model and unless the Government has evidence of a market failure, we would support continuation of the current differentiated regimes.

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.

50. Although we can see some merit in establishing a companies regulator we think that the UKLA should be retained within the CPMA. Separating the market monitoring activities and the UKLA into separate institutions would reduce the ability to monitor for potential market abuse e.g. in relation to primary issuance for listed entities. Additionally, the proposed split would mean that the UK regulatory bodies would not as naturally link-in to corresponding EU and international bodies. This would diminish the UK's voice at the negotiating table. Also it would be sensible for HM Treasury to retain over sight of the UKLA along with the broader

financial architecture. If the Government is minded to create a companies regulator we would urge it to consider and quantify the costs and benefits in its impact assessment.

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.**

51. Please see response to question 17 above.

Crisis management

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

52. We generally welcome the arrangements for crisis management, particularly the assignment of a single lead regulator (the Bank) in such circumstances.

53. With regard to RRPs we stress that these are a last resort and have to be considered within the wider regulatory context. In particular, effective regulation, risk management, market discipline and corporate governance are the key to ensuring that they are rarely used.

54. An overriding principle should be that a privately owned financial institution should be able to conduct itself as a going concern (assuming it is so), in accordance with the legal obligations to its shareholders to hold capital and liquidity which should be appropriate to the risks inherent in the particular business.

55. Well managed, international banks like Standard Chartered Bank provide a buffer for financial shocks. Our diversification across businesses and geographies provides significant strength. We are able to provide liquidity and capital into troubled markets for our customers in times of increased stress.

56. Crisis management should be risk based recognising the „starting point' of an institution. RRPs should be high level and scenario based setting out high level management actions. They should not be used as a vehicle for changing company structures or a move to subsidiarisation, which is an illusory benefit (as it creates other problems such as fragmentation of capital and liquidity strength, and will lead to replication of interdependencies through other means such as guarantees and indemnities).

57. We welcome the thought leadership in this area, however it is essential there is international consistency on implementation and the G20, FSB and BASEL committees should work towards harmonisation of relevant regulation on an international basis.

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?

58. We are not in favour of "making intervention mandatory at a specified approach" as has been suggested by the Government; this would be an unwelcome application of the "tick-box" approach that the Government has rightly stated it is moving away from. The Bank, FPC and CPMA must be left to exercise judgment in this crucially important area.

59. We highlight the Government's stated intention to "develop options to end the culture of „tick-box' regulation, and instead target inspections on high-risk organisations through co-regulation and improving professional standards"[3] and await the additional details that the Government has committed to producing in its plan on 2011. We urge HM Treasury and BIS to closely cooperate on these issues.

60. We believe the Government should be focusing on ensuring that the relevant regulatory bodies are equipped with staff with sufficient experience and skills to make these judgment calls – which can make or break UK financial stability and the wider UK economy.

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?

61. The Government has rightly recognised that the accountability of bodies involved in the SRR is imperative especially as there are potential conflicts between/within the various bodies e.g. the Bank's role as lead resolution authority and the Bank's role in the PRA. Whilst handing leadership of resolution issues to the Deputy Governor for Financial Stability (as opposed to the CEO of the PRO) will help to manage that conflict, the Government needs to set out other processes and mechanisms by which it can promote accountability – and request further elaboration and consultation on this.

Impact assessment

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

62. Clearly there will be one-off costs in managing the transition to the new regulatory architecture and regimes. The Government's estimate is in relation to costs incurred by the

[3] http://www.number10.gov.uk/wp-content/uploads/SRP-BIS.pdf

regulators; we also expect the Government to provide an industry estimate using the assumption that the regulatory splits (FPC, PRA, CPMA) are enacted. As regards ongoing costs of compliance these should be proportionate and kept to a minimum by ensuring that unnecessary duplication between the organisations is eliminated. Provisional ideas to be explored include:

- Single authorisation process through the CPMA
- CPMA to calculate and collect fees and tariffs
- Joint IT systems
- Joint rule book
- Bodies to consult one another in advance of any prospective rule changes
- Close working relationship between the bodies
- Regulatory reporting could be channelled through one of the regulators and to the extent that multiple reporting is required the regulators should be required to employ standardised reporting templates

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18 October 2010

By email: financial.reform@hmtreasury.gsi.gov.uk

Dear Sir/Madam

A new approach to financial regulation in the UK

I write on behalf of Standard Life plc, a major UK FTSE 100 listed company, and its UK regulated subsidiary companies. HM Treasury's encouragement of debate on a new approach to financial regulation is welcome.

At Standard Life we are committed to putting the customer at the heart of our business. We believe that an innovative and competitive business is central to achieving positive outcomes for all our stakeholders. We support a robust regulatory framework that can maintain high standards of customer protection whilst enabling innovation and competition within the industry. Our response to your consultation paper is positioned with this in mind.

In reviewing the consultation paper we liaised closely with the Association of British Insurers, contributing to its response. Standard Life supports the ABI's position.

I would like to emphasise some key points which are especially important from the point of view of Standard Life plc as an issuer of securities, Standard Life Investments Limited as an investment firm and asset manager and Standard Life Assurance Limited and its subsidiaries as an insurer:

- The focus of the proposals is on the banking sector. In many respects this is entirely understandable given recent history. However, it is important that the interests of insurers and asset managers are fairly represented. A more balanced approach is essential to safeguard the interests of these sectors, their customers and their vital contribution to the UK economy. We recommend that the insurance and asset management sectors are included on the FPC, PRA and CPMA boards.

- Duplication of effort and additional costs for both regulators and firms can be reduced by creating a shared services model for certain responsibilities. These responsibilities include authorisation of individuals, the enforcement process, financial reporting and fee-collection for dual-regulated firms.

- We are keen to participate in any discussion on the creation of a "companies' regulator", once the role of the CPMA has been clarified. However, we are unconvinced as to the case for merging the UK Listing Authority with the FRC. As you know, the FRC's role to date has been to promote high quality financial reporting, mainly through issuing principles-based guidance, and to oversee the regulatory activities of professional accountancy bodies. We are not persuaded that it would be a logical step to extend this role to cover the activities currently undertaken by the UKLA. We believe that, if these two bodies were to merge, it could result in listed firms having to report to two regulatory entities. We are concerned at the potential duplication of costs and additional operational complexity this could bring.

- The PRA and CPMA must have regard to each other's objectives and to work together to achieve consistency in their approach to a judgement-based supervision system. This is key in avoiding an unlevel playing field for the industry. If the regulators mandate different prudential supervision rules, this could disadvantage asset managers.

- It is essential to position the proposed changes in the context of EU regulatory developments and their significance for UK business. We welcome the opportunity for the industry as well as UK regulators to be actively involved from the outset in the stakeholder groups of the new European Supervisory Authorities. We are happy to contribute our expertise and experience to support this.

Standard Life's detailed response to the consultation paper's specific questions is attached.

Yours faithfully

David Nish
Chief Executive
Standard Life

HM Treasury's consultation: a new approach to financial regulation
Standard Life's response

Question ref.	HM Treasury questions	Standard Life response
1	Should the FPC have a single, clear, unconstrained objective relating to financial stability and its macro-prudential role, or should its objective be supplemented with secondary factors?	We would expect parliamentary oversight of the FPC to be a statutory provision. We support the suggestion of supplementing the FPC's primary objective with secondary factors.
2	If you support the idea of secondary factors, what types of factors should be applied to the FPC?	We support the suggestions set out in section 2.28 of the consultation paper for secondary factors. Issues such as the economic and societal impact of the FPC's decisions should be considered so that the FPC has to take into account the impact of its decisions on the wider economy as well as the PRA and CPMA.
3	How should these factors be formulated in legislation – for example, as a list of „have regards' as is currently the case in the Financial Services and Markets Act 2000 (FSMA), or as a set of secondary statutory objectives which the FPC must balance?	The FPC should have a legal duty to show that its decisions are consistent with the objectives of the PRA and CPMA.
4	Should the PRA have regard to the primary objectives of the CPMA and FPC?	Yes. Each of the new bodies should have regard to the other bodies' objectives to ensure an holistic approach overall to achieving financial stability and consumer protection.
	Should some or all of the principles for good regulation currently set out in s2 FSMA, particularly those relating to good regulatory practice, be retained for the PRA?	We assume that reference to "s.2 of FSMA" relates to Part I, 2 (2) of the FSMA. The principles set out in Part I 2 (2) (a)-(c) of FSMA should be retained for both the PRA and the CPMA. Section 2 (2) (c), the objective to reduce financial crime, may not be appropriate for PRA. However, this may remain appropriate for the CPMA depending on where responsibility for reducing financial crime sits (CPMA or Economic Crime Agency ?).
	Should the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of	Yes.

Question ref.	HM Treasury questions	Standard Life response
	regulatory action be retained? Are there any additional broader public interest considerations to which the PRA should have regard?	The UK needs a strong voice in Europe when the European Insurance and Occupational Pensions Authority (EIOPA) comes into effect in January 2011. The PRA (and the Pensions Regulator) should represent the UK at the EIOPA. This representation is necessary to ensure UK interests are adequately considered so that innovation and competition are not adversely affected, which could restrict consumer choice.
5	Is the model proposed in paragraph 3.16 – with each authority responsible for all decisions within their remit subject to financial stability considerations – appropriate, or would an integrated model (for example, giving one authority responsibility for authorisation and removal of permissions) be preferable?	We believe there is potential for gaps and confusion between the remits of the PRA and CPMA, therefore an integrated model would be preferable for dual-regulated firms for all overlapping responsibilities e.g. approving significant influence function personnel or granting permissions. However, if such an approach is developed, it will need to be made clear where an integrated model applies and where an individual regulatory body has sole responsibility. It is unclear how Standard Life Investments Ltd, as an asset manager with an insurance group parent, will be regulated going forward. Asset managers are to be prudentially regulated by the CPMA and insurers are to be prudentially regulated by the PRA. We would prefer that Standard Life Investments Ltd be regulated as an asset management group of companies by the CPMA alone.
6	Is the approach outlined in paragraph 3.17 to 3.23 for transfer of regulatory functions and rule-making sufficient to enable the PRA to take a more risk-based, judgement-focused approach to supervision?	Proposed enhancements of the role of external auditors and forthcoming introduction of the ring-fencing of a firm's internal audit significant influence function are examples of how a risk-based approach can be developed. We would welcome continuity with the FSA's current principles-based approach. It is essential for clear criteria and standards to be set, which can be applied in making judgements. Measures will need to be in place to ensure consistency of approach within and across the regulators.

Question ref.	HM Treasury questions	Standard Life response
7	Are safeguards on the PRA's rule-making function required?	Yes. The rule-making process should be transparent and there should be clear accountability for the process. It is important that notice of rule changes should be adequate to allow sufficient time for implementation. We would like to see a PRA Practitioner Panel set up along the lines of the FSA Practitioner Panel, to provide an independent view of the PRA's effectiveness at meeting its objectives.
8	If safeguards are required, how should the current FSMA safeguards be streamlined?	Current FSMA safeguards include: • Having a transparent consultation process for rule creation/change • Having a Financial Services Practitioner Panel and a Consumer Panel who consider whether FSA policies and practices are consistent with its statutory objectives and principles. • Having a Complaints scheme for anyone wanting to complain about the failures of the regulators • Requiring a review or enquiry to be undertaken against the FSA. There does not appear to be an obvious need to streamline the existing UK processes.
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. *(Governance, Board and management structures, transparency and accountability, funding)*	The proposed representation is heavily weighted towards banking sector. This risks neglecting the interests of the UK insurance and asset management industry. We recommend that appropriately experienced insurance individuals are appointed to a number of senior positions within the PRA to ensure a balanced approach to regulation by the PRA.

Question ref.	HM Treasury questions	Standard Life response
10	Should the CPMA have regard to the stability of firms and the financial system as a whole, by reference to the primary objectives of the PRA and FPC? Should some or all of the principles for good regulation currently set out in s2 FSMA be retained for the CPMA and if so, which? Should the requirement to have regard to potential adverse impacts on or innovation or the competitiveness of the UK financial services sector by regulatory action be retained? Are there any broader public interest considerations to which the CPMA should have regard?	Yes. This will help achieve an integrated approach to financial regulation, reducing the risk of each body taking a different approach to supervisory issues, that could otherwise weaken the overall objective of stability. The principles set out in Part I 2 (2) (a)-(c) should be retained for PRA and CPMA. However, 2 (2) (c) – the objective to reduce financial crime -may remain appropriate for the CPMA depending on where responsibility for reducing financial crime sits (CPMA or Economic Crime Agency?). Innovation and competition have given the UK financial sector its leading position. Some firms may be regulated by both PRA and CPMA and may suffer a competitive disadvantage. The judgement-based approach, particularly if regulators lack skilled resource, may result in firms being regulated differently at the level of individual firms. Supporting an innovative and competitive marketplace will be to the benefit of consumers, providing a range of products and providers to choose from. Retail customers can now buy investment solutions through a variety of „wrappers'. For instance customers can buy UK Equity exposure through a regulated collective investment scheme or an insured life or pension „wrapper'. It would appear that collectives will be regulated under the CPMA while insured products may be regulated under the PRA. Whether a customer is buying a „wrapped' or „unwrapped' product, similar regulatory requirements should apply to provide the customer with consistent protection and ensuring that no product providers are disadvantaged. The CPMA is a regulatory body – it is inappropriate for it to be a consumer champion. That could compromise public understanding of its role and also its regulatory effectiveness, which is also important for consumers. It would be more beneficial for the industry to build productive relationships with existing

Question ref.	HM Treasury questions	Standard Life response
		consumer groups. The CPMA will represent the UK at the European Securities and Markets Authority, (ESMA) that comes into effect in January 2011. This representation is needed to ensure UK consumer protection interests are adequately considered during the development of EU rules.
11	Are the accountability mechanisms proposed for the CPMA appropriate and sufficient for its role as an independent conduct regulator?	It would be appropriate to maintain the accountability mechanisms currently applied to the FSA. We suggest carrying forward the Consumer Panel from the FSA into the CPMA. Equivalents of the FSA's Practitioner Panel and Small Business Practitioner Panel should be created, to provide an independent view of how effectively the CPMA is meeting its objectives.
12	The Government welcomes views on the role and membership of the three proposed statutory panels for the CPMA.	Representatives from all types of firm regulated by the CPMA should be included across the panels to ensure a fair balance of views.
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 bodies and associated bodies.	We support any proposals that would reduce duplication of effort. Therefore having one body collecting fees for all regulators/associated bodies is necessary. Considering this proposal further, we suggest a joint "services" body be created that has ownership of key overlapping issues such as fee-collection, authorisation of individuals and administration functions. This should remove duplication of effort and ensure a more integrated approach to these processes.
14	The Government welcomes views on the proposed alternative options for operating models for the FSCS.	The Financial Services Compensation Scheme (FSCS) should be the sole compensation scheme covering all firms across all regulatory bodies. A separate consultation process would be appropriate to consider potential operating systems for the FSCS. Any developments should be mindful of the EU's intention to examine introducing rules to protect policyholders in case of a

Question ref.	HM Treasury questions	Standard Life response
		failing insurer by means of Insurance Guarantee Schemes.
15	The Government welcomes views on the proposed division of responsibilities for markets and infrastructure regulation.	We would be keen to ensure asset management regulation was given sufficient influencing powers in its negotiations with the PRA and investment bank regulation so that asset management issues are adequately represented and not overlooked. In order ensure that asset managers can obtain best outcomes for their clients it is key that the new regulatory structure applies consistent environments to regulated firms. As an asset manager we will interact through the market with firms authorised by other regulators. In order to be able to create a level playing field in these markets it is key that firms are subject to similar standards of supervision. Asset managers are different from the banks and insurance companies in that they act as agents for their clients. They do not take principal risk and do not represent systemic risk. It is important that the new regulatory structure recognises this and that asset managers are not subjected to the same prudential requirements as banks and insurers.
16	The Government welcomes views on the possible rationalisation of the FSMA regimes for regulating exchanges, trading platforms and clearing houses.	There is a need for the new regulatory bodies to balance “sell side” and “buy side” interests. Investment managers, as users of the market on the “buy side”, act on behalf of their clients: pension funds, charities and ordinary investors. There needs to be an effective mechanism for their voice to be heard. The objectives of the CPMA should allow for that, and the Bank of England, in its role as regulator of all exchanges, clearing and settlements systems, should take the “buy side” views into account.
17	The Government would welcome views on whether the UKLA should be merged with the FRC, as a first step towards creating a companies regulator under BIS.	We would be keen to participate in any discussion on the creation of a “companies’ regulator”, once the role of the CPMA has been clarified. We would support a single comprehensive consultation on all the elements of this

Question ref.	HM Treasury questions	Standard Life response
		proposal, rather than a piecemeal introduction of changes which may not be final, should a companies' regulator be formed. We do not believe that merging the UKLA with the FRC would be a positive development. The FRC's role to date has been to promote high quality financial reporting, mainly through issuing principles-based guidance, and to oversee the regulatory activities of professional accountancy bodies. We do not believe that it would be a logical step to extend this role to cover the activities currently undertaken by the UKLA. We believe that, if these two bodies were to merge, listed entities could be in the position of having to report to two regulatory entities and we are concerned at the potential duplication of costs, operational complexities and overlaps this could bring.
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.	Given that the extent of the current proposals under discussion is already wide, and given the possible changes and implementation challenges as a result, we believe that the matters disclosed in 5.22 as coming within the remit of the companies' regulator (corporate governance, corporate information and its disclosure and the stewardship of companies by institutional shareholders) is comprehensive.
19	Do you have any overall comments on the arrangements for crisis management?	As inadequate crisis management was a key element of the rationale for these proposals, more detail is essential at this stage. This section focuses on the banking sector. Proposals should be included to address insurer and asset manager failure and also the impact on of bank failure on the rest of the financial sector. Any proposals should take into account the crisis response powers of the European Supervisory Authorities (ESAs).
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?	Existing rules should be sufficient to ensure firms adequately identify and manage their risks by way of systems and controls and conduct of business. FSMA also provides for Own Initiative Variations on Permissions (OIVoPs) to be applied – and it is worth considering carrying this

Question ref.	HM Treasury questions	Standard Life response
		forward into the PRA's and CPMA's remit. It is the regulators' responsibility to ensure they have robust supervisory methods and suitably qualified staff to be able to identify and understand firms' risks so that financial failure/crises can be avoided. Government should also be mindful that the ESAs will be able to challenge or override the UK regulators' actions/decisions.
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?	Legislative changes will be required if the Special Resolution Regime is to be carried forward into the new regulatory structure, given that it currently only applies to banks.

Our ref.	Additional comments
i)	**The European dimension** The proposals are inward-looking, touching only briefly on the EU. The proposals should be repositioned in the context of the following: • the UK is an international financial centre • Its regulator should have a credible presence in EU now to represent the national interest – Solvency II, PRIP proposals, etc. • closer international co-operation is essential to avert global financial crises • the European Systemic Risk Board (ESRB) and ESAs will be operating from January 2011 UK financial regulators will be expected to work more closely with their counterparts in other EU Member States to achieve a smooth flow of relevant information between competent authorities. UK regulators should be seconding experts into the European Commission and other international regulators to enhance their skills base. As the CPMA is the sole voice on ESMA, a process must be designed for handling prudential issues.
ii)	**Industry representation** A better balance between banking and insurance is needed throughout the proposed regulatory structure. We suggest that suitably qualified and experienced insurance personnel are recruited into a number of senior roles within the PRA and CPMA to ensure that there is adequate understanding of the insurance industry when the regulatory bodies undertake their supervisory duties.

Our ref.	Additional comments
	Asset managers are different from the banks and insurance companies in that they act as agents for their clients. They do not take principal risk and do not represent systemic risk. We recommend that the new regulatory structure recognises this fact and that asset managers are not subjected to the same prudential requirements for banks and insurance companies.
iii)	**Rules** At this stage we would welcome clarity as to what will happen with the FSA rulebook. We would like to see the PRA and CPMA adopting as much as possible that is fit for purpose from existing FSA rulebooks. Completely replacing the rulebooks would be a costly exercise for both Government and industry. However, many current FSA functions do not map across into the new regime. An example of this is the enforcement process, where the new structure may result in multiple enforcement regimes. It needs to be clear how enforcement and the various current functions will map into the new structure. Using an integrated model, as we suggested earlier, could address this issue. The rule-making and decision-making processes under the new UK regulatory structure will need to be flexible enough to take account of the ESAs' powers. With the forthcoming creation of a European single rulebook, UK financial regulation will need to be able to incorporate changes in EU rules and guidance in a timely and cost-effective manner. We encourage the development of a consistent method of communication across the new regulators
iv)	**Transparency & Accountability** We expect Parliament to have oversight of the FPC. Consultation approaches should be defined at this stage. We support a transparent and inclusive consultation process being adopted for both the PRA and CPMA – similar to the current FSA consultation process. However, a list of exceptions would need to be defined where, for example, it might be necessary for the PRA to make a rule change without undertaking the full consultation process. Such a list would not be expected to be extensive. Criteria are required to define the consultation process. There may also be exceptions when a full consultation process is not appropriate and such circumstances need to be defined to ensure consistency of approach.
v)	**Unlevel playing field** If the PRA and CPMA mandate different prudential supervision rules this would create discrepancies between double and single-regulated firms, leading to an unlevel playing field. We therefore reiterate the need for both bodies to have regard to each other's objectives and work together to achieve consistency in their approach to a judgement-based supervisory system.
vi)	**Transitional arrangements**

Our ref.	Additional comments
	We have concerns that whilst the UK regulatory system undergoes transformation in the next two years, routine regulatory decisions may be deferred and new EU initiatives may receive less scrutiny and challenge than required. We are keen for the change to occur swiftly and with as little upheaval to existing regulatory plans so that the industry can continue to work with the regulators in delivering a trusted and valued service. However, Government should consider that the regulators and the financial services industry will need to provide appropriate resources to developing the new regulatory framework, participating in consultations and legislative drafting and adapting systems and controls to fit the new requirements. This could present significant resource constraints across the industry at a time when there are also current UK and European regulatory developments due to be implemented in the next two years (Retail Distribution Review and Solvency II requirements).

Sir

I am required to register with the FSA. My company supplies insurance and risk management consultancy to one non UK resident company. My annual fee income is in the region of £50,000.

Regulation compliance incurs in the region of £2,000 p.a expenditure. In drawing up your new regulations would you please take into consideration the position of companies like mine where the remedy seems to outweigh the need and it is difficult to identify what are the benefits to me. Wouldn't it be possible to apply some de minimus rule exempting companies below a certain income and activity level?

Regards

Peter Talbot

P F Talbot ACII FIRM

Chartered Insurance Practitioner

Managing Director

Woodthorpe Associates Limited registered in England number 24952

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HM Treasury Consultation

A new approach to financial regulation: judgement focus and stability

Response by Tomorrow's Company

To be read in association with the response by Tomorrow's Company on the BIS Consultation on narrative reporting tomorrow's company

Introduction

Tomorrow's Company has had a major influence on the issues raised in this consultation as a result of a large body of agenda setting work on the themes of company law, corporate governance, corporate reporting and, most recently, stewardship.

It is the organisation responsible for the revival of interest in the issue of stewardship, following its 2008 Report, *Tomorrow's Owners – stewardship of tomorrow's company* whose conclusions were reflected in the Walker Report on the governance of Banks and other Financial Institutions.

Tomorrow's Company has been consulted by successive Ministers and civil servants in HM Treasury as well as BIS on this range of issues. HM Treasury was a participant in its 2004 study Restoring Trust – investment in the twenty-first century which urged the financial services industry to take a much tougher approach to its own self-regulation, in particular advancing the idea of the "Hippocratic Oath" for the financial services industry, an idea which is now attracting renewed interest following the financial crisis,

More details of the work of Tomorrow's Company are described in Appendix One.

Scope of this response

In this consultation, however, we have confined ourselves to Questions 17 and 18, which concern company regulation. Our response is intended to be read in conjunction with our response to the BIS Consultation on narrative reporting.

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 very much agree with the concept of a companies regulator. The key issue here is one of coherence. At present it is possible for company directors to find themselves facing contradictory guidance from FSA and FRC. This follows the logic of the useful thinking on this at paras 5.16 sqq of the 2001 Final Report of the Company Law Review. It is a matter of regret that the previous Government did not adopt the proposal (at para 5.21 sqq) for a Company Law and Reporting Commission.

Whatever the precise division of labour, and whatever the precise arrangements for accountability BIS is the natural supervisory department for all matters of companies regulation, including listing, accounting, audit, measurement and reporting. In our own discussions of governance matters Tomorrow's company has come across examples where there is a conflict between the practice required or recommended by the FSA, and that under Company Law and the Combined Code/UK Governance Code regime. The question of what constitutes a concert party is one example.

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.

Q18 There is one other potential candidate for additional inclusion under the umbrella of the proposed companies regulator and that is the Takeover Panel. This is at present in the (probably unique) position of being an unincorporated association which is effectively an industry body with some external appointments, but is nevertheless recognised by statute (Ss 942 sqq of the 2006 Companies Act) and performs regulatory functions. It is amenable to judicial review as a public body (which it resisted but lost - the 1987 decision of the Court of Appeal in the *Datafin* case) and eventually and reluctantly conceded that its appellate process should be ECHR-compliant. While the Panel is rightly to be commended for its speed and flexibility, this is not incompatible with its being brought into an appropriate integrated regulatory regime. As the issues raised in the Cadbury case illustrated, Government policy concerning takeovers extends well beyond the process of holding the ring while competing bidders and bid-for companies fight it out. For example, in our evidence on narrative reporting we have pointed out to BIS that both bidders and defenders should be required to produce an Operating and Financial review setting out their intentions. In the same way a companies regulator may need to look more closely at bidders promises of post-merger rationalisation. Whatever the precise design of the regime for regulating takeovers, this regime does need to belong to a wider set of design principles covering the influence of government policy over the whole operation of the companies sector overall.

Appendix One About Tomorrow's Company

Tomorrow's Company is an agenda setting 'think and do' tank which looks at the role of business and how to achieve enduring business success. We focus on strong relationships, and clear purpose and values as the foundation of effective leadership and governance.

In our programmes we challenge business leaders around the world to work in dialogue with others to tackle the toughest issues. We promote systemic solutions, working across boundaries between business, investors, government and society.

We believe that business can and must be a 'force for good. This in turn requires a strengthening of stewardship by shareholders. We argue that the Age of Sustainability has begun, and that in the future success and value creation will come from recognising the 'triple context' – the links between the economic, social and environmental sub-systems on which we all depend, and the opportunities this brings.

On behalf of Trafford Facilities Ltd (established 1959) - Independent Insurance Consultants - I am responding to the Consultation Document "A new approach to financial regulation: judgement, focus and stability".

I wish to comment on the following two questions:

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.

Answer 13

We agree that the CPMA should be the fee and collecting body, however we feel that further consideration should be given to the smaller (family
run) broking insurance firms, such as ours, which offer a personalised service to members of the community.

The CPMA should ensure that the initial base rate is suitably tiered so that smaller firms are not unduly penalised and that larger firms that cause greater risk pay a greater contribution.

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

Answer 14

Consideration should be given to FSCS funding to ensure that:

-banks and money market elements should be kept separate from the rest of the market as they have been seen to have a greater risk element than other bodies

-other contracts such as Payment Protection Insurance and Pensions should have a different levy from those which provide General Insurance contracts which have a lower risk element i.e. home, motor, travel and leisure products such as boat and private aircraft insurance which are unlikely to call upon the FSCS either in number or quantum.

The CPMA should therefore concentrate on protecting the consumer and the smaller businesses like ours, thereby stimulating and maintaining the national recovery more effectively.

Yours sincerely

G.A Hill

Director

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October 2010

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

Status of Comments

This submission is made by and on behalf of True Research Limited, a small, FSA-regulated, consultancy firm which undertakes investment research for institutional investors and advises biotechnology companies. True Research Limited is owned entirely by its directors and is ***not*** directly involved in market-making, stockbroking, investment management, routine servicing of retail clients, large-company corporate finance or the sponsoring of flotations. Our views on many subjects are therefore relatively independent of the usual commercial lobbies. The key regulated persons at True Research Limited have all held senior positions in financial services companies of very varied size and have considerable collective experience.

This document has been written within True Research Limited by Barbara Arzymanow, a founding director. The views expressed have been discussed with and represent the collective opinion of all regulated persons within the firm. She has no other commercial or professional ties but discloses that she is an active Member of the Conservative Party. This submission not only reflects the interests and experience of True Research Limited but also aims to give wider, largely independent thoughts on recent proposals to reform the UK regulatory framework in the financial services industry.

Our Responses to Questions for Consultation

This document responds to all the questions.

The headings and questions from the original Treasury paper are in blue. Our responses are in black.

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?

It should be supplemented by secondary factors. These should be ones that enhance the freedom of the FPC in order to ensure that the FPC is not prevented from acting by legal technicalities over the breadth of its objectives. The legislation should be framed so that secondary factors cannot constrain carrying out the primary objective. Secondary objectives could also ensure that certain matters are looked into without in any way limiting the powers of the FPC to look at other matters.

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

We cannot comment precisely on what should be in the secondary objectives because it depends on what appears elsewhere in the legislation. However, the FPC should be able to act on, or get another relevant regulator or body to consider acting on, any macro development in the financial services industry that can be argued to be against the public interest. The FPC will be the main body looking at macro issues in financial services and any ideas should not be wasted just because they do not relate directly to financial stability. Examples include identifying anti-competitive practices, unnecessary obstacles to innovation, threats to the international competeviness of UK financial services companies and factors relevant to the long-term, non-cyclical direction of the economy.

The most important constraints on the FPC, although these are not objectives, are: always acting in a proportionate way; not breeching confidentiality except in accordance with clear guidelines; managing any conflicts of interest amongst committee members; and not criticising individual companies in public as this is a micro-regulatory role.

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?

This depends on the factor. Where the FPC should definitely do something or consider something that a court of law or the FPC might not find obvious the secondary objectives should be statutory and compulsory. We cannot think of any good example but other commentators may do so. A list of “have regards” should include the objectives of other regulators. A third list of things that the FPC may do, if and when it wishes in the public interest, would be helpful. Our suggestions in reply to Q2 largely fall into this category.

Prudential regulation authority (PRA)

4 The Government welcomes respondents’ views on:

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

Yes, the PRA should have regard. The interests of regulators should be aligned whenever this can be done without compromising effectiveness.

- 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;

They should all be retained as they are all appropriate to good regulation.

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

This should definitely be maintained. The disappointing performance of the FSA reflects the limited time and expertise devoted to innovation and competitiveness. These matters require more attention, not less.

The FSA’s failings are undeniable. For example, innovative firms seeking to provide investment research to institutional investors without the conflicts of interest inevitable in brokers and investment banks have been and still are unintentionally stifled by rules concerning payments, inducements and commission. On the other hand ludicrously risky trading activities, particularly by banks on their own account in derivatives, have been inappropriately condoned.

We believe that the PRA can do better. A prudential approach to innovation and competitiveness is appropriate because new ideas need the most monitoring. The rules must be updated on an ongoing basis to take account of innovation. They must not stifle innovation that involves acceptable risk by leaving in place rules that were not drafted with the new service in mind. However, there is nothing clever about innovation with unacceptable risk. Any market-maker can gain market share very rapidly by offering better prices than any competitor or trading heavily on his firm’s own account, possibly in the guise of derivatives, but he will make heavy losses when he reads the market wrongly. The UK's international competitiveness then suffers. A regulator should be able to develop the skills to get the balance right and question intelligently what regulated firms say. The FSA made the mistake of not thinking enough from first principles and accepting the consensus views of large banks and investment banks as well as long-established life assurance companies and supposedly well managed building societies. In fact, a lot of the views of these organisations have been plain wrong, whilst others reflected their collective vested interests. The FSA was not appropriately structured and staffed to give an effective response.

See also our answer to Question 10.

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

A political view should be taken about whether there should be any controls on staff bonuses. If so, the PRA would be the best regulator to enforce them. As believers in free market forces, we do not believe that high bonuses are unacceptable providing that they are paid out of genuine profits made without undue risk and after taking into account past losses. Competitiveness does however need to be considered, because struggling firms or the UK as a whole cannot afford to lose the best staff to others paying higher bonuses.

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 benefits of separation outweigh the drawbacks because each regulator will have a clear focus and ethos.

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

Yes.

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

Yes.

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

Some FSA rules do not have the intended effect because circumstances have changed or because attitudes did not change in the way that the FSA expected. For example, institutional investors have shown little interest in whether research is deemed "independent". Providers of research are therefore often happy to label all their research in the least burdensome regulatory category. This approach is rather like labelling ***all*** food "may contain traces of nut".

There should be a procedure under which regulated firms should be allowed to submit proposed rule changes to financial regulators publicly and get a reasoned, public response. In order to limit abuse, there could be a financial levy (costing more for larger firms) on applications in excess of a reasonable number each year. Consideration should be given to whether there should be an appeal procedure.

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

We agree with these paragraphs

Consumer protection and markets authority (CPMA)

10 The Government welcomes respondents' views on:

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

Yes. Aligning the interests of regulators is generally helpful.

- 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

They should all be kept because they all help good regulation.

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

It should definitely be kept. The failures of the FSA do not mean that future regulators will behave in the same way, especially given the lessons learned.

The encouragement of appropriate innovation and international competitiveness is self-evidently desirable. Innovation and short-term competitiveness that could lead to instability are bad and discouraging or banning undesirable practices does not have an adverse impact on anything worth preserving.

The main ways in which regulators can help innovation and international competitiveness are: by making any rule changes necessary to remove inappropriate barriers to desirable innovative behaviour on a regular basis; by taking into account what safeguards overseas persons and organisations would like to see in the UK; by ensuring that the regulations appropriately take into account the circumstances of foreigners; by entering into appropriate recognition and co-operative arrangements with overseas regulators subject to maintaining standards; and by reducing bureaucracy.

See also our answer to Question 4.

And

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

- the potential impact of policies or regulatory decisions on consumer and business lending;
- promoting public understanding of the financial system;
- the need to maintain diversity in the financial services sector (for example, by: removing barriers to entry where possible; ensuring that its rules do not disadvantage mutually owned financial institutions and small companies offering specialist services; and championing the consumer and good wholesale practice from a position of having the necessary expertise to make independent judgements in the public interest).

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.

The panels should be allowed to comment on anything that they choose. It is vital that the panels be of high calibre and broad experience and that the members can commit sufficient time to fulfil their obligations.

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

We support the proposals. However, we are concerned that the transitional period may involve one-off costs and that small businesses should not face substantial increases in total regulatory expenditure.

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

The FSCS should administer and make rules for all aspects of compensation. This system will achieve the highest consumer confidence and be easy to understand.

Cross-subsidies of one type or another are inevitable. For example, a highly conservative bank with a strong balance sheet and a strongly secured loan book well matched to its borrowings has to pay if a bank that takes high risks fails. So conservative banks are effectively cross-subsidising reckless ones. A system that made more attempt to match a firm's fees to its risk profile would be helpful. However, this does not imply a need for different regulators to be involved, except in making risk information available to the FSCS. A further advantage of having just one body is that specific risks are more widely spread and so failures do not impact most on similar companies that may have related problems.

Markets and infrastructure

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

We support the proposals.

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

Rationalisation is appropriate but we do not consider ourselves sufficiently expert to comment on the detail.

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

We think that the UKLA should come under the CPMA because the main issues relate to protecting the public and other investors in securities. There would be a benefit in merging the UKLA and the FRC but not great enough to justify separation from the CPMA. Perhaps the UKLA and the FRC should be merged but under the CPMA rather than under BIS. The proposed new companies regulator could also come under CPMA and so leave BIS to deal with the extremely important issues of innovation and skills.

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

If the companies regulator were brought under CPMA, there could be roles in respect of company pensions regulation, better control of inside information and financial crime within companies.

Crisis management

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

As a broad generalisation companies and individuals want their borrowings not to be capable of being called in at short notice. Lenders on the other hand prefer instant access, although some can be persuaded to invest for short fixed terms (usually up to a maximum of five years) or with notice periods in return for a higher interest rate. Inevitably banks and building societies on average borrow for shorter periods than they lend. For this reason few banks could withstand a complete loss of confidence by depositors and money markets without Government help. A loss of confidence can begin through irrational fears or rumours. A financial crisis can be triggered and snowball with very little warning at any time and the Government must always stand ready to take the required decisions. Supervision, however good, cannot be guaranteed to give much notice of runs on banks.

In a crisis quick, decisive action is needed. Post mortems and reports to fulfil accountability obligations must come later. The immediate task requires everyone’s powers and responsibilities to be clear, including the management of the organisation in trouble. We approve of the proposals insofar as they go but further details must be worked out carefully.

The guarantees of FSCS are important in reducing the risks of a run on financial services companies.

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

The right to intervene at or beyond a particular point is important but whether and when this right is exercised should be decided on a case-by-case basis.

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?

Accountability procedures should be followed retrospectively and not cause a distraction during the height of the crisis. Afterwards in severe cases a full enquiry could be held at which all senior people involved can explain their actions. If the authorities behaved inappropriately the question of compensation to affected parties can be raised. An appropriate system should be in place that can achieve a much more rapid resolution than in the case of Equitable Life.

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 insufficient detail to comment on the impact of costs at this time.

THE UKCARDS ASSOCIATION

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Contact
Jacqui Tribe

26 August 2010

Dear Sirs

Re: A New Approach to Financial Regulation

The UK Cards Association is the leading trade association for the cards industry in the UK. The Association is the industry body of financial institutions who act as card issuers and/or acquirers in the UK card payments market. It is responsible for formulating and implementing policy on non-competitive aspects of card payments. Members of The UK Cards Association account for the majority of debit and credit cards issued in the UK, issuing in excess of 58m credit cards and 79m debit cards, and covering the whole of the plastic transaction acquiring market. The UK Cards Association is a joint sponsor of the Lending Code.

The Association promotes co-operation between industry participants in order to progress non-competitive matters of mutual interest and seeks to inform and engage with stakeholders to advance the industry for the ultimate benefit of its members' consumer and retail customers and as an Association we are committed to delivering a card industry that is focussed on improved outcomes for the customer.

While the consultation document covers a range of proposed key structural changes, the one that is of most interest and relevance to us and our Members is the new Consumer Protection and Markets Authority (as detailed in section 4 of the consultation and questions 10 – 14). This response therefore provides general card industry comments and makes specific reference to the proposed CPMA.

If you have any comments regarding the content of our submission, I and the team at UK Cards would be happy to meet with you to explore particular industry views in more detail.

Yours faithfully

Jacqui Tribe
Manager Legal, Regulatory and Schemes

General Comments

As an industry we support the principles of transparency, consumer protection and ensuring that consumers are placed in an empowered and informed position.

We have, in our discussions with HMT, BIS and other key stakeholders, made known our support, in principle, for the concept of a single regulator for Conduct of Business. The current regulatory environment is, we believe, confusing for consumers and financial institutions alike. In the case of consumers there is confusion over which regulator is responsible for any particular aspect of the firms business; in the case of financial institutions there is significant risk of double-jeopardy where there is a blurring of responsibility, ‘scope creep’, or interpretation of the more general regulatory requirements. We would therefore welcome a regulatory framework that seeks to remove unnecessary regulatory burdens and duplication while providing clarity for both the consumer and business.

While supporting the concept of a single regulator in principle, we believe that there is still a significant amount of detail required to define how a single regulator framework would operate in practice including aspects such as the role of the Bank of England in relation to the CPMA (e.g. extent of oversight and where the burden of accountability rests). Such detail is fundamental to enable a considered and definitive industry position being reached.

Section 4 Questions

10. The Government welcomes 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 do not have specific comments on all of the points raised above we are of the opinion that any proposed action should not distort market competition or innovation as this would ultimately be to the detriment of the consumer and, potentially, the wider UK economy.

We would suggest that the CPMA should have regard to areas of industry Best Practice as these are seen as an effective and dynamic tool for reflecting changing requirements placed on industry in a more efficient manner than can be achieved through legislation.

We would also encourage a proportionate and balanced view to be taken with regard to those aspects where consumer information is under consideration. While we fully support an informed consumer there is a balance to be struck between this and information overload (which could have the opposite effect).

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

These would appear to be appropriate given the nature of the CPMA.

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

We have no specific comments on the role and membership of the three statutory panels.

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

As a trade body we do not feel it appropriate to comment in any detail on proposed funding arrangements as we believe that our Members will have specific, and potentially differing, organisational views.

Nevertheless, we believe that if the CPMA is to act as the single regulator, it would not be unreasonable for our Members to consider a corresponding reduction in other areas (or regulators) where they are currently seeing funding apportioned among industry participants.

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

This is not a particular issue for the card industry as, in a cards-specific environment, the role and operating models of the FSCS only become relevant where credit card accounts are in credit – a scenario that we would see as the exception to the norm.

Consumer Credit and the role of the OFT

We appreciate that the Government intends to consult on the merits of a transfer of responsibility for consumer credit from the OFT to the CPMA and very much welcome the opportunity to provide an industry response as this is a key area of consideration for our Members and where as an industry we have a number of comments and views we would wish to make known.

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14 October 2010

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

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

Dear Sirs,

I am pleased to submit a response on behalf of UK Shareholders' Association ("UKSA") to Cm.7874. We would like you to regard this as directly on behalf of consumers. UKSA is the leading independent body in the UK representing the interests of individual shareholders: our membership is made up entirely of private individuals and we are financed by their subscriptions.

We widen our remit to include the interests of savers generally. We have taken a great interest in the proposals in the most recent Retail Distribution Review (RDR), which we see as absolutely necessary to remove the present commission bias in financial advice.

Fundamentally we believe that any regulatory framework should put the needs of individuals first and last – there is no brief for the government to assure the profitability of an industry, only to assure that its conduct contributes to the public good. That belief informs our comments below

General remarks

For clarity, in this submission we follow the Treasury's (and indeed the Financial Services Authority's) preferred designation of individuals as 'consumers', although the use of this term has hitherto resulted in the FSA concentrating on purchasers (or consumers) of products rather than the wider remit of savers and investors generally.

We are pleased to see that responsibility for protection of consumers has been separated from the prudential regulation of firms. However, we strongly suggest that the Markets function sits uneasily within the same authority as consumer protection. We fear that the responsibilities for markets will divert attention from consumer protection, and the stated objectives for the new body already suggest some confusion of focus (see our Appendix to this submission). In fact exactly the same arguments as apply for separating the PRA and the CPMA seem to apply to separating "M" from "CPA".[1] Furthermore it is not obvious to us why the Markets function cannot fall under the PRA which seems its natural home. By this means the regulatory objectives concerned with the efficiency and prosperity of the industry will be separated from those concerned with consumer protection. In other words, the first subdivision of the FSA's "monolithic" (1.5) powers should be between the interests of suppliers and the interests of consumers.

If that change is made, others could follow - leading to a simpler, cheaper and more effective structure. The most significant (explained more fully below) would be for the CPA to harness the unpaid power of the public; eventually we also envisage the elimination of the Financial Services Consumer Panel (whose functions could be assumed by the CPA) and proper independence for the Consumer Financial Education Body (CFEB).

A side-effect would be that the UK's representation in the European Securities and Markets Authority (ESMA) would naturally fall to the PRA. This could be a step towards meeting concerns that have been expressed about the effect of the split of the FSA on the UK's standing in ESMA.

Inevitably a consultation document produced so quickly in a very complex area has some rough edges and some inconsistencies. In our Appendix we take the opportunity of pointing out some of the inconsistencies (some of which would be removed by adoption of our proposal for a CPA). Overall, it is vital that the final structure of regulation does not include confused accountabilities.

It will always be difficult to achieve, by regulation, a result opposed to the direct interests of those regulated, witness currently:

- the nettle of commission bias that is only now, very belatedly, being grasped by the FSA,
- the persistence of obscure charging structures which make it easier for providers to levy excessive charges, and
- with profit contracts issued by proprietary life offices where the interests of policyholders are subordinated to those of shareholders.

Possible changes and economies

We suggest that the new structure, like the old, fails to take advantage of potential input from the public. We propose that a channel should be created whereby members of the public would be invited to submit comments on products and practices that were perceived as disadvantageous to consumers. Some of such public 'comment' might indeed be incorrect, misinformed, irrelevant, ignorant or libellous. But some of it - from those who are active investors or knowledgeable customers for investment products (which does not necessarily apply to those working in regulation) - won't be.

For example, any reasoned analysis of precipice bonds would have immediately spotted that they were unsuitable for the general public (being negative insurance, i.e the undertaking of a small – but, sadly, not small enough – risk of a large loss in exchange for a small enhancement of income). The FSA may have been aware of this, but was

[1] See para 1.20: "*Prudential and conduct of business regulation require different approaches and cultures, and combining them in the same organisation is difficult. As a result of the combined remit of the FSA, participants in financial services and markets, particularly ordinary consumers of retail products, did not always get the degree of regulatory focus or the protection they may have expected or required*".

unable to act because of the bias of its remit in favour of support for the industry and against consumer protection. But the public can supply these insights – at little cost – and the CPA should have the capacity to access and act on them. This would be consistent with 4.52: *"…. a more proactive, interventionist approach to retail conduct regulation by the new regulator…..".* A small filtering department would be necessary but the cost would be negligible compared with the benefit of early detection of potential problems.

The paper envisages the retention of the Financial Services Consumer Panel ("FSCP") see para 4.38). The FSCP has done sterling work within its ridiculously limited budget but has not been nearly powerful enough to make a worthwhile contribution to consumer protection. A strong CPA solely responsible for consumer protection, properly independent of the industry and helped by direct interaction with knowledgeable members of the public should allow the FSCP to be absorbed within it.

Consumer education

We are somewhat surprised that so little is said in the paper about the role of the Consumer Financial Education Body (CFEB), seeing that that body is now up and running with a budget of almost £33 million in its first year. Financial education is vital, not just for those struggling to make ends meet day by day, but at least as much for those who are in a position to save. The demise of final salary pension schemes means that individuals must save more on their own initiative. A strong educational push is essential to make saving being more effective.

Despite the claims made for the Pathfinder project, we have seen nothing in the media about it, nor about the CFEB's plans for the future. By now we feel that it should have secured more in the way of public and media attention. The progress of this body needs to be kept under careful appraisal and we would like to be assured that the CPMA will be checking on its achievements well before the 3 to 5 years proposed in the consultative paper for the first review.

We also question the commitment to the CFEB's independence. The statement in 4.49: *"The CFEB will remain operationally independent, with limited points of accountability to the CPMA, such as final approval of its budget and plans ·* despite the hopeful use of the word 'limited', could almost be a definition of the means by which a holding company controls a wholly-owned subsidiary in the commercial world. Referring to *鼎FEB's independence ·* in the sentence that follows will not make it so. Savers, like any learners, must be able to trust their teachers; subordination to a body that does not have their interests completely at heart would undermine that trust. This criticism would not apply if our proposal for a CPA were to be adopted.

Staffing

We note that the paper has much to say about board selection, board structures and inter-communication at board level. But the day-to-day routine work of regulation will be done at relatively low levels in the staff hierarchy and the secondary considerations must be dealt with at supervisory levels where the overall impact of the day-to-day work can be reviewed. There are many questions in the paper where the best people to answer would be those who have already worked in the regulatory sphere and have been able to observe the strengths and weaknesses of the current set-up.

Moreover, while the paper covers in some detail the question of intercommunication at top level, it is silent on exchange of information and cross-fertilisation at lower levels. Equal attention needs to be paid to this if the regulatory processes are to be effective.

There may still be lessons to be learnt from the Equitable Life debacle and the failure of the Government Actuary's Department to act on all the warning signs. It may be worthwhile to re-examine the relevant chapters of Lord Penrose's report to make sure that the weaknesses disclosed are adequately covered under the new structure. There appears to have been a serious lack of co-ordination between the prudential regulators and those regulating the sales function (chapter 20, paragraphs 64 to 67). Since insurance companies are to be prudentially regulated by the PRA (to whom presumably the 60 odd actuaries employed by the FSA will be transferred) while the sales side will be regulated by the CPMA, there will be scope for the same to happen again unless adequate provisions for intercommunication are firmly established.

We shall, of course, be pleased to expand on any aspect of these comments at your convenience.

Yours faithfully,

John Hunter,
Director

Replies to Consultation questions

The Bank of England and Financial Policy Committee (FPC)

1 Should the FPC have a single, clear, unconstrained objective relating to financial stability and its macro-prudential role, or should its objective be supplemented with secondary factors?
The former – we cannot see that diluting the prime objective can be helpful

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

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? N/A

Prudential regulation authority (PRA)

4 The Government welcomes respondents' views on:
•whether the PRA should have regard to the primary objectives of the CPMA and FPC; Yes
•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; See 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; We believe this principle should be removed as it provides an excuse for not criticizing new ideas or products that are in fact damaging to the consumer. The regrettable reality is that many complex new products are constructed in such a way as to give maximum benefit to the provider at the consumer's expense and no principle should stand in the way of appropriate regulatory action. The idea is, anyway, sufficiently covered by another principle in the FSMA (2.3.(e)): *{The authority must have regard to} the international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom*;
•whether there are any additional broader public interest considerations to which the PRA should have regard. We believe that the 'have regard' in the FSMA concerning competition – "*the need to minimise the adverse effects on competition that may arise from anything done in the discharge of those functions;*" – should be supplemented by the phrase "with 'competition' defined to include the availability of different types of service as well as the availability of competing firms within a service type." An example would be the cosy arrangements for underwriting new stock issues – where there is apparently free competition for underwriting business but no facility for capital-raising that is not under-written.

5 Is the model proposed in paragraph 3.16 – with each authority responsible for all decisions within their remit subject to financial stability considerations – appropriate, or would an integrated model (for example, giving one authority responsibility for authorisation and removal of permissions) be preferable? We cannot see any benefit from concentrating all authorisations in one place. If our proposal to remove "M" from "CPMA" is adopted the main bodies authorised by the CPA will presumably be IFAs and the like. Their authorisation would appear to fall naturally

under the CPA. Before the FSA came into being, separate bodies existed for various sections of the industry and this did not seem to cause problems.

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? No comment

7 Are safeguards on the PRA's rule-making function required? No comment

8 If safeguards are required, how should the current FSMA safeguards be streamlined? No comment

9 The Government welcomes views on the measures proposed in paragraphs 3.28 to 3.41, which are designed to ensure that the operation of the PRA is transparent, operationally independent and accountable. No comment

Consumer protection and markets authority (CPMA)

10 The Government welcomes respondents' views on:
•whether the CPMA should have regard to the stability of firms and the financial system as a whole, by reference to the primary objectives of the PRA and FPC; Possibly but this must not be carried so far as to admit of practices damaging to consumers.
•whether some or all of the principles for good regulation currently set out in section 2 of FSMA should be retained for the CPMA, and if so, which; Same principles apply as in 4 above
•whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained; No (see 4 above)
•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? Sufficient, certainly– at first sight they could be thought excessive.

12 The Government welcomes views on the role and membership of the three proposed statutory panels for the CPMA.
As indicated in our preliminary remarks we suggest that a strong body devoted solely to consumer protection should lead to the position where there is no longer a need for the FSCP. Contrarily, with the CPMA as proposed the budget, powers and scope of the FSCP must be enhanced for adequate oversight of the consumers interests

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.
It is vital that budgetary control is just as tight as if they were funded by the Treasury and subject to all the discipline that would impose.

14 The Government welcomes views on the proposed alternative options for operating models for the FSCS. No comment

Markets and infrastructure

15 The Government welcomes views on the proposed division of responsibilities for

markets and infrastructure regulation. We disagree with this division. It just is not true to suggest, as stated in 5.15, that 'clear distinctions can still be drawn between the different types of infrastructure firms'. Or if it's true today it won't be true tomorrow. To create an artificial distinction of this type in such a fast-moving and innovative industry is an invitation to confusion. The regulation of all infrastructure should be brought within the remit of the PRA.

16 The Government welcomes views on the possible rationalisation of the FSMA regimes for regulating exchanges, trading platforms and clearing houses. No comment, except that the fact that different regimes have grown up for overlapping functions illustrates our point in answer to 15 above

17 The Government would welcome views on whether the UKLA should be merged with the FRC, as a first step towards creating a companies regulator under BIS. We agree with the merger. The principles of information flow between a quoted company and its stakeholders are fundamental to good governance and efficient allocation of capital and it now makes little sense to separate regulation of financial reporting from regulation of other corporate information flows

18 The Government would also welcome views on whether there are other aspects of financial market regulation which could be made more effective by being moved into the proposed new companies regulator. No comment

Crisis management

19 Do you have any overall comments on the arrangements for crisis management? No comment

20 What further powers of heightened supervision should be made available to the PRA and the CPMA, and in particular would there be advantages to mandatory intervention, as described in paragraph 6.17? No comment

21 What are your views about changes that may be required to enhance accountability within the SRR, as described in paragraphs 6.21 to 6.24? No comment

Impact assessment

22 Annex B contains a preliminary impact assessment for the Government's proposals. As set out in that document, the Government welcomes comments from respondents on the assumptions made about transitional and ongoing costs for all types of firm. In particular, comments are sought from all types and size of deposit-taking, insurance and investment banking firms (including credit unions and friendly societies), and from groups containing such firms. The impact assessment should include an estimate of the benefit to consumers of effective regulation. The potential gain is equal to the difference between the economic cost of providing consumer services and the actual cost, this difference being the rent extraction arising from market inefficiencies, oligopolistic practices and the uncontrolled exploitation of consumer ignorance. We estimate this at a minimum of 1% per annum of the total savings of private individuals not managed through corporate pension funds.

Appendix: Inconsistencies

We wish to draw attention to the following inconsistencies in the consultative paper:

Re the FPC

1.11: The FPC will be a transparent and accountable institution……

but

2.55 The Government recognises that there are concerns around releasing commercially confidential details or information that may have a destabilising effect for individual firms or the market more widely. The Government will consider the best way to achieve the maximum level of transparency for the FPC without risking premature publication of destabilising or market sensitive material.

We sympathise with the difficulty, but the conflict between transparency and market confidence that is rightly identified in 2.55 must prevent the FPC from being a 'transparent' institution

Re the CPMA

1.21 The Government will therefore create a dedicated consumer protection and markets authority (CPMA) with a primary statutory responsibility to promote confidence in financial services and markets. This objective will have two important components. First, the protection of consumers through a strong consumer division within the CPMA. And second, through promoting confidence in the integrity and efficiency of the UK's financial markets.

We do not see how an objective can have 'two components'. This can only mean there are two objectives. In which case the proposal must indicate how conflicts between the two objectives are to be resolved. As our letter states, this is a problem created by not separating market regulation from consumer protection

4.6 The Government will legislate to provide the CPMA with a primary objective of ensuring confidence in financial services and markets, with particular focus on protecting consumers and ensuring market integrity. This objective will allow the CPMA to adopt a focused and specialized approach to all aspects of conduct regulation.

The protection of consumers has ceased to become an objective and turned into a 'particular focus'. What does " a primary objective …. with particular focus ….." mean when the 'particular focus' is two objectives that can be in conflict both with each other and the primary objective?

We also suggest that there is too much emphasis on confidence instead of protection as a primary objective, both here and in 1.21. If the CPA is successful in promoting consumer protection the confidence will follow, but not the other way round.

1.22 In its consumer-focused role, the CPMA will therefore take on all the FSA's responsibilities for conduct of business regulation and supervision of all firms, as well as arms-length oversight of the Financial Ombudsman Service, the Consumer Financial Education Body, and the Financial Services Compensation Scheme. The creation of a *regulator with specific responsibility for consumer protection will ensure that the interests of consumers are not forgotten about or subordinated.*

What does 'arms-length oversight' mean? Almost anything that it could mean seems inconsistent with 4.44 : *'It will be important for FOS to remain independent of the CPMA . '*. And the second sentence of 1.22 is just a pious hope unless the meaningless word 'specific' is replaced with the word 'primary'.

Re the Prudential Regulatory Authority (PRA)

2.17 The Government will therefore legislate to create a new Prudential Regulation Authority (PRA), which, while operating under the auspices of the Bank of England, with a board chaired by the Governor, and a chief executive who will also occupy the newly created post of Deputy Governor of the Bank for prudential regulation, will nevertheless be a separate legal entity.

2.18 This will ensure that the day-to-day operations of firm-specific regulation will be undertaken by the new PRA, rather than falling to the Bank itself. In addition, the creation of a new Deputy Governor post will increase the capacity and breadth of the Bank's senior management team."

The first sentence of 2.18 implies some merit in the separation of the PRA from the Bank, while the power of appointment of both the Chairman and Chief Executive ensures that de facto control remains with the Bank . '*Operating under the auspices of*….' is itself a meaningless phrase.

**Unite the Union response to a consultation by HM Treasury:
A new approach to financial regulation**

This response is submitted by Unite the Union. Unite is the UK's largest trade union with 1.5 million members across the private and public sectors. The union's members work in a range of industries including financial services, manufacturing, print, media, construction, transport, local government, education, health and not for profit sectors.

Unite is the largest trade union in the finance sector representing some 150,000 workers in all grades and all occupations, not only in the major English and Scottish banks, but also in investment banks, the Bank of England, insurance companies, building societies, finance houses and business services companies.

Executive Summary

- Unite believes the review should consider a new approach to engagement with all stakeholders who have an interest in the success and sustainability of the industry;

- The role of Non-Executive Directors should include consumer and employee representation to align the interests of the business with those of stakeholders;

- Unite sees a role for trade unions and consumer group representation on the Consumer Protection and Markets Authority (CPMA) to address the democratic deficit;

- Unite would wish to see reforms around the issue of financial exclusion and welcomes the recognition of this issue in the consultation paper;

- Unite has concerns regarding the Government's commitment to increase diversity in the sector given the recent sale of RBS branches to Grupo Santander;

- Unite believes that there must be an acknowledgement of the social responsibility the sector has beyond the interests of shareholders and a clearer understanding of its role in serving the needs of society as well as the wider economy.

Introduction

1. Unite welcomes HM Treasury's proposals to consider a new approach to financial regulation which will ensure "a credible and appropriately intrusive approach to regulation and supervision". However Unite believes the review should also consider a new approach to engagement with all stakeholders who have an interest in the success and sustainability of the industry. This should include a reassessment of the sales culture and aggressive business practices which are evident in some parts of the sector.

2. This response focuses on issues of corporate governance, increasing representation in the decision making process within finance sector institutions, financial inclusion and issues surrounding increasing diversity within the sector.

3. Unite recognises that the financial services sector does make a valuable contribution to the UK economy and its success and sustainability is dependent on the trust of businesses and customers.

4. Unite recognises that regulation requires a review. The regulatory system in place prior to the crisis failed to recognise the potential consequences associated with excessive risk and short term returns. A new approach is required which will deliver a more robust checks and balances function by ensuring all stakeholders are involved in the process. This "new approach" should include trade unions and consumer group representatives on key decision making boards and committees at the highest possible level.

5. In a speech at Mansion House in 2009 Lord Adair Turner, Chairman of the FSA said "parts of the financial services industries (sic) need to reflect deeply on their role in the economy, and to recommit to a focus on their essential and economic functions, if they are to regain public trust." [1]

6. While early signs of a recovery within the sector are beginning to emerge, the impact of the crisis on workers in the sector appears to have been overlooked by the industry itself.

7. The workforce appears to be regarded as a dispensable commodity with many workers having been discarded by their employers under the auspices of cost cutting measures. According to the Office for National Statistics, since March 2009 to March 2010, 90,000 finance related jobs have been lost. [2] These decisions affect livelihoods, careers and futures for workers in the sector who have been damaged irrevocably by a crisis brought about by city dealers, failures by regulators and the actions of excessive risk takers within the boards of many large finance sector companies.

8. Unite believes that a full workplace impact assessment should be carried out by businesses when large scale job losses are proposed in order to identify suitable alternative employment opportunities wherever possible and

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[1] http://www fsa.gov.uk/pages/Library/Communication/Speeches/2009/0922_at.shtml
[2] ONS Economic and Labour Market Review Sept 2010 Edition

to take account of local, regional and national economic implications. Businesses should be prepared to engage with the public sector to identify redeployment possibilities.

9. In an industry where some Chief Executives earn 108 times the basic pay of those in the lowest grade[3], it is time to bring fairness and some humility upon the industry. Sir Philip Hampton, chairman of RBS stated recently that "regulation rather than self-imposed restraint is the only way to reduce City bonuses". [4]

10. Unite's response to the Treasury Committee's call for evidence on the Banking crisis in January 2009 stated that:

> *"Financial regulation should not be seen in isolation. Most fundamentally the objective of a stable financial system must be re-orientated to serve the real economy, fund long term investment, provide returns and with wage increases reflecting productivity growth. "*

11. It went on to say:

> *"The more traditional relationship between bank and lender, consumer and company was a better model. A higher share of national wealth should be returned to workers as wages reducing the need for such high levels of personal debt. The financial system should be democratically accountable to wider social objectives. "*

12. The sector must be prepared to adopt changes to the existing structures of financial regulation and corporate governance that will see a radical shift to a more equitable distribution of a company's wealth and a review of the existing business model to one which considers ethical principles as well as profit. Only then will the sector be in a position to regain its integrity and deliver a responsive banking system which is sustainable and works in the interests of society more widely.

Corporate Governance

13. Unite responded to the HM Treasury review of corporate governance in October 2009 in which it stated that

> *"NEDs have a duty to scrutinise on behalf of the wider public and shareholders however they are often provided, through the remuneration system, with access to share option schemes in the company. This may therefore compromise their independence, as any criticism of decisions made by the board, could impact on their pay packages."*

[3]Stephen Hester CEO RBS - basic pay in 2009 was £1.2 million. The basic pay of the lowest grade in RBS is £11,144 (equates to 108 times highest to lowest pay.)
[4] Guardian 5 October 2010 pg 22

14. The function of Non-Executive Directors (NEDs) is an important one. However it is vital that this function should provide independent oversight which is robust. Unite would therefore wish to see an increase in NEDs who are able and willing to provide unbiased guidance and direction which will reflect the diverse interests of all stakeholders. Remuneration for this role should be reviewed.

15. Unite believes that independent NEDs should include consumer and employee representation to align the interests of the business with those of stakeholders. The present system which would appear to recruit NEDs from a narrow group of individuals from within the sector itself can create a situation where albeit informed individuals may be driven to support self interest and this can dictate the decision making process away from the wider interests of society.

16. Unite believes that to promote good governance which takes account of the role financial companies play in the wider economy, a number of seats should be reserved for public interest representation on internal committees such as remuneration committees.

17. Ensuring public interest involvement will further allow for independent scrutiny and provide legitimacy and objectivity to the policymaking and decision-making process. A report commissioned by Unite and carried out by the Financial Inclusion Centre identified:

> *"Too few independent, well-resourced public interest representatives at the heart of the regulatory system whether at international, European Union or UK national level."* [5]

Representation

18. Unite sees a fundamental failing in the proposals outlined in that there remains an over-representation of shareholder interests over public, employee or wider social interests in the decision-making process. Retaining the composition of such groups is unlikely to deliver independent oversight or provide checks and balances to improve corporate governance structures.

19. Unite commissioned the Financial Inclusion Centre to look at the UK financial services sector and to prepare a report detailing the areas that required overhaul. The Report highlighted the need for radical reform including the need for the creation of utility banks with public interest objectives.

20. The Report identified that a serious democratic deficit existed in the UK's financial system with an over-representation of shareholder interests over public, employee or wider social interests on many of the board and committees of financial institutions in the UK and therefore in the decision–making process.

[5] Financial Inclusion Centre Report: Reforming Financial Systems 2009 (page 10)

21. With regards specifically to point 4.12 in the consultation paper, Unite sees a role for trade unions and consumer group representation on the Consumer Protection and Markets Authority (CPMA) to address the democratic deficit. While there may be a call for such engagement to take place at the statutory panel level Unite would be disappointed that full engagement with key stakeholders would only take place on a consultative basis and not at a decision-making level.

22. Unite recognises that there were failings in the previous system which has severely damaged the sector. The sector has to be seen to be reassuring consumers, re-engaging the workforce and refocusing on putting things right.

23. Unite welcomes the proposed transparency of the CPMA and the expectations proposed in point 4.32 that board members should have the necessary skills and background to bring the viewpoints of all relevant stakeholders to the board. Unite would welcome the opportunity for trade unions to be represented on this board in order to represent the interests of its members at this strategic level.

Financial inclusion

24. Unite would also wish to see reforms around the issue of financial exclusion and welcomes the recognition of this issue in the consultation paper.

25. There are now increasing numbers of individuals who through over-indebtedness have found themselves financially excluded when trying to access new financial products, with increased number of people filing for bankruptcy in the last two years.

26. Statistics from the UK Office for National Statistics found that in Q1 2010 there were 16,348 individual bankruptcy petitions made by debtors (the person who owes the debt) a 20% increase on the previous quarter. However this is a decrease of 3% on the same quarter of 2009. [6]

27. In a discussion forum of eminent thinkers for Consumer Focus in June 2010, Brian Pomeroy CBE, Chair, Financial Inclusion Task Force stated that:

> *"Not having a bank account has many disadvantages. Without one, you often cannot get a job since employers do not have to pay their staff in any other way; and unbanked people who receive cheques from their employers can pay substantial additional fees to have them cashed. Not having a bank account means your money is less safe and more vulnerable to theft or loss. A bank account also makes it possible to get discounts on everyday necessities by using efficient payment methods. Suppliers of gas, electricity, water and telecommunications, who receive money electronically - for example by direct debit – have considerably lower costs than if they*

[6] http://www.justice.gov.uk/publications/docs/insolvency-bulletin2010-q1.pdf

have to handle cheques or cash. Not only does it lower their administration costs, it also reduces the likelihood of missed payments and default, so utilities offer discounts to people who pay in this way. But only if you have a bank account can you take advantage of them." [7]

28. Although the Post Office does offer a basic bank account – the Post Office Card Account (POCA) – this was intended as a means of paying welfare benefits electronically and does not have the functionality of a traditional bank account. Credit unions also offer access to bank accounts and loans; however they remain very small players and are distributed unevenly across the country.

29. Unite has given its support to the Better Banking Campaign which calls for a reform of the banking system which will introduce measures including:

    - Requiring banks to publicly disclose where they are lending and providing services – how much and to whom – including in respect of small businesses;
    - With this data, providing incentives and obligations for banks to serve social responsibilities, along the lines of the US Community Reinvestment Act;
    - Capping the amount that can be legally charged for credit;
    - Reinvesting 1% of banks' profits for public benefit.

Diversity

30. Unite believes that a fundamental re-evaluation of banking is necessary to address issues of financial exclusion and a reassessment of financial markets to take account of societies needs with regards to financial services. Unite believes that a diverse finance sector is the best model to take account of the different needs within society. This should include the expansion of credit unions, cooperatives, mutuals and building societies to provide services which can compete with the large retail banks who dominate the UK high street.

31. The UK's top six banks account for 88 per cent of retail deposits while in Germany and the US the figures are 68 per cent and 35 per cent respectively. Britain's financial sector is dominated by a small number of very large universal banks. [8]

32. Unite therefore welcomed the Coalition Government's statement contained within the Coalition Agreement that "we agree to bring forward detailed proposals to foster diversity, promote mutuals and create a more competitive banking industry." [9] However Unite has concerns regarding the Government's commitment to increase diversity.

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[7] Consumer Focus: Rethinking Financial Services Focus on Finance June 2010
[8] FT 26 September 2010
[9] Coalition Agreement - http://www.cabinetoffice.gov.uk/media/409088/pfg_coalition.pdf

33. The recent sale of RBS branches to Grupo Santander will do little to increase diversity. According to the company's website Santander is already the 4th largest bank in the world [10] and controls a significant proportion of UK high street banking [11] which has narrowed the number of providers and is likely to limit the choice of products and services on offer to consumers.

34. Consolidation is increasingly becoming a feature of the UK finance sector and Unite believes that future takeover and mergers must be fully investigated by the Competition Commission and the Office of Fair Trading to ensure that such business decisions are in the best interests of all relevant stakeholders including customers, the workforce and the public generally.

35. The sector has much to do to regain trust, redeem lost confidence and rebuild reputation. To do this Unite believes that there must be an acknowledgement of the social responsibility the sector has beyond the interests of shareholders and a clearer understanding of its role in serving the needs of society as well as the wider economy.

36. The threat that banks and other firms in the sector will simply move out of the UK if changes to the regulatory regime, corporate governance or even the remuneration regime become too burdensome, should not be a reason to do nothing but rather should provide the stimulus to find a new approach to the way the finance sector conducts business which supports society's needs and contributes positively to the economy.

Rob MacGregor	Cath Speight	Siobhan Endean
National Officer	**National Officer**	**National Officer**

October 2010

[10] www.santander.com – about the group
[11] Grupo Santander already owns Abbey, Alliance and Leicester and Bradford and Bingley.

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

Submission by Virgin Money

Introduction

1. We appreciate the straightforward recognition of the causes of the financial crisis, which included global imbalances and misunderstood risk, the failure of the tripartite system and, as stated in paragraph 1.7, the fact that "financial supervision relied too much on 'tick-box' compliance … at the expense of proper in-depth and strategic risk analysis."
2. We support the proposals to create a more robust framework for regulation to achieve greater financial stability in future, including the establishment of the FPC, responsibility for macro and micro prudential regulation within the same organisation and the separation of micro prudential regulation from consumer protection.
3. We welcome the intention to introduce a more judgement-based approach to regulation, as emphasised in the heading "judgement, focus and stability", set out in paragraphs 1.13 and 1.17, and repeated throughout the document.
4. We welcome the recognition of the need for a degree of flexibility in adapting the regulatory tools after the initial learning process, and subsequently reviewing them periodically to ensure that they are still appropriate.
5. We welcome the intention to introduce greater transparency through the publication of regular reports by the relevant bodies.
6. We shall be happy to support and work constructively with the new framework which is being proposed to meet the financial stability objectives set out in the document.

7. While impressed by the well-considered proposals for financial regulation, and by their publication for comment so soon after the election, we consider it disappointing that the document does not say more about competition, particularly given that, in a parallel development, the Independent Commission on Banking has been asked to look at possible structural and non-structural reforms to promote both stability and competition in banking. Whatever reforms are suggested by the Commission, and accepted by the Government, both stability and competition will require regulation – preferably by a different part of the same body, to reduce the risk that actions on one topic have unintended consequences on the other.
8. We also have reservations about the proposals in the document relating to the CPMA – how its intended role as consumer champion will relate to the OFT, which has a similar objective,[1] whether it can police complex financial market transactions as well as retail products (Initiatives such as the Retail Distribution Review and Mortgage Market Review suggest a concentration on retail activities), whether it is best placed to write the prudential regulation framework for financial institutions not regulated prudentially by the PRA, and whether it can effectively achieve arms-length oversight of the Financial Ombudsman Service, the Consumer Financial Education Body and the Financial Services Compensation Scheme.

[1] "The OFT's mission is to make markets work well for consumers", OFT Financial Services Strategy, April 2009, page 9

9. As a recent new entrant and still relatively small provider of personal financial services, we do not feel that it is appropriate or would be valuable for us to comment in turn on each of the questions set out in the paper. However, we would like to take this opportunity to comment on four issues associated with the proposals: judgement, accounting, risk assessment and competition.

Judgement

10. We strongly support the intention to introduce greater judgement into the risk management process, in particular to deal with two direct questions which were asked by the Treasury Committee.[2] These questions are, essentially, "Will it work?" and "Fighting the last war?"
11. "Will it work?": It seems that large banks have taken a view that, as long as they comply with the regulations, anything that is not prohibited is permitted.[3] Banks got round Basel I by securitisation, and then got round Basel II by derivatives and off balance sheet structures. Financial stability should benefit from requiring the use of more judgement by banks in observing regulations and by regulators in enforcing them.
12. "Fighting the last war?": It is not possible to anticipate in regulations all possible future developments in economic and market conditions. Stress tests based on or at least influenced by previous extreme situations may not be appropriate for the future. Reverse stress testing is a powerful tool to make sure that we are attempting to understand what the next war might be. Financial stability should benefit from greater judgement in applying the regulations to situations not specifically foreseen by them.
13. The move from simple compliance to greater judgement implies a significant change in culture, both in the banks and in their regulator. Cultural change is always difficult. In this case, it will be difficult to change the behaviour of risk managers who have become used to an environment of compliance, and who may be unwilling or even unable to change in the required direction. As in other cultural changes, rather than try to force universal change, and risk unsettling core activities, it may be more practical first to encourage in banks (and possibly in their regulator) small, specialist strategic risk teams, which would be free to probe and challenge the data gathered by their colleagues through the still essential compliance monitoring of risk activities. Gradually, the example of the specialist teams could be used to achieve the necessary change in culture across all risk management activities throughout the bank. This should strengthen the second line of defence which is built into most governance models.
14. There may also be need for cultural change at Board level, so that the Board can make the necessary judgements about the adequacy of capital and liquidity positions, rather than simply ensure compliance with the regulations. The need for greater judgement will require Boards to have proper understanding of macro and micro risks relating to their activities, and to the financial system as a whole, matters which should be considered in the routine interviewing and competency assessment of anyone undertaking a SIF function by the FSA. They will also require at Board meetings proper debate on risk issues, not just approval of risk papers.
15. The introduction of reverse stress testing later this year presents an excellent opportunity to further require Boards to debate possible risks and to express judgements about them. However, to prevent

[2] New Inquiry into Financial Regulation, Treasury Committee, 28 July 2010

[3] "The Basel Accords set the framework for international finance. From the beginning the banking system saw them as a hurdle to overcome , or circumvent", Don't be fooled again, 2010, Chapman, page 192

the obvious danger of a reversion to ritualisation and compliance, it may be sensible to require Boards to hold, at least annually, a "challenge" session at which:

- The emphasis would be on discussion and debate, which might be facilitated, but not through long presentations.
- There would be a genuine attempt to identify possible risks. Given the admitted lack of challenge by auditors,[4] and the obvious practical difficulties for internal people to be critical within an ongoing collegiate environment at the Board, it might, if following this approach, be sensible to require or at least encourage the use of external risk specialists, as recommended in the Walker Review,[5] to challenge current risk exposures and to provoke discussion about possible future "Black Swan" risks in connection with the reverse stress testing exercise.

16. The introduction of more judgement may imply the need for greater professionalism, as was suggested by the Future of Banking Commission at the end of its report.[6] We strongly believe in the benefits of business ethics in Virgin Money, including our duty to society, and would support the introduction in banking of a professional code (as for doctors and teachers) with appropriate but fairly-determined penalties for breaching the principles of the code.

Accounting

17. Whatever the risk methodology and governance process, the assessment of risks by boards, shareholders and regulators relies on audited figures which should be fit for purpose and in which the users can have confidence.
18. The financial crisis raised concerns about weaknesses in accounting standards:
    - Incurred loss provisioning for loans, and marking to market for securities, were both pro-cyclical, and they contributed to the need for banks to raise additional equity capital at difficult times.
    - It is difficult for the public to have confidence in accounting standards which require incurred loss provisioning for loans, including sub-prime loans, held in the banking book, but mark-to-market accounting for equivalent loans held in securitised form in the banking book (discounting all expected future losses).
19. We welcome proposals to move from incurred loss provisioning to expected loss provisioning and to reduce the application of mark-to-market accounting.[7] However, we suggest that, before finalising the new accounting policies, serious thought should be given to possible future unintended consequences. We also suggest that serious consideration should be given to the likely durability of the new accounting policies, given that accounting changes requiring re-statement of prior years' financials cause management to lose their points of reference, and are disproportionately expensive and burdensome for smaller providers including new entrants.

[4] "Both the FSA and the FRC believe auditors need to challenge management more. Arising from its more intensive approach to supervision, the FSA has questioned whether the auditor has always been sufficiently sceptical and has paid adequate attention to indicators of management bias", Enhancing the auditor's contribution to potential regulation, FSA and FRC, June 2010
[5] The Walker Review, November 2009, page 86
[6] The Future of Banking Commission Report, June 2010, pages 76-77
[7] Independent Commission on Banking Issues Paper, September 2010, page 58

20. Our recollection is that a reason for the IFRS approach, with incurred loss provisioning and mark-to-market accounting, was to avoid judgements through which managements could accumulate “hidden reserves” and could “smooth” their profits – although, as pointed out in Box 2C of the document, Spain appears to have benefited from allowing such flexibility. Consistent with the proposed changes in accounting policies, and with the focus on judgement in this document, we strongly believe that there should be a return to the concept that auditors are required to express their professional judgement that the accounts give a “true and fair view” of the company’s financial position – or, if not, why not.

Risk assessment

21. Since the financial crisis, various initiatives have been taken to increase equity capital requirements considerably, to tighten liquidity requirements, and to reduce the pro-cyclical impact of accounting policies. Despite these initiatives, and the Government’s intention to introduce a more effective framework for achieving financial stability, we still have some concerns about the underlying requirements of Basel II (and, in future, Basel III) in relation to risk assessment and disclosure.
22. The detailed methodologies set out in Pillar 1 to quantify capital requirements for corporate credit and market risk under the advanced approach can lead to an inappropriate sense of security that compliance with the regulations is sufficient to cope with these risks. However, the methodologies are based on value-at-risk models, whose limited abilities to allow for extreme situations have been recognised by many commentators.[8] The standard approach relies on an assessment of the credit risk associated with specific borrowers, based on ratings by credit rating agencies, which have been unreliable.
23. Simply increasing overall capital ratios, in response to the recent problems, may lead to excessive capital in benign economic circumstances. As various parties have suggested recently, this could limit banks’ ability to support economic growth[9] and could either reduce their returns to shareholders or could encourage shareholders to support higher-risk approaches, to increase returns. On the other hand, the higher overall capital ratios might still not provide adequate capital to cope with extreme situations such as those that caused the recent financial crisis.
24. Because of the limitations of the Pillar 1 risk models, it is necessary to give greater attention to the Pillar 2 assessment of other risks and stress tests, including the new reverse stress testing, and the Individual Capital Guidance determined by the local regulator, which allow greater judgment and flexibility. But, while Pillar 3 requires substantial disclosures about the Pillar 1 risk analysis, information about the internal models used by large banks, stress tests and Individual Capital Guidance does not have to be disclosed, and this unfortunately removes an important element of market scrutiny and discipline. We understand that, in the parallel regulation of life insurance companies under Solvency II, equivalent disclosures will be required to enable market discipline.

[8] “The financial crisis of 2007-2008-2009 has shown with painful clarity the limitations of the purely statistical techniques (such as Value at Risk (VaR) or Economic Capital) that were supposed to provide the cornerstones of the financial edifice”, Coherent Stress Testing, 2010, Rebonato, page 1
[9] The Daily Telegraph, 30 September 2010, Business, page 1

Competition

25. The only significant reference to competition in the document appears to suggest that, in a period of light-touch regulation, there was too much competition and innovation.[10] This comment related to complex new financial transactions - and its sentiment is supported in a recent commentary on the financial crisis.[11] However, the Issues Paper recently published by the Independent Commission on Banking helpfully distinguishes between competition that is good (providing customers with what they want) and competition that is not so good.[12]
26. The concern about too much competition and innovation related to competition which did not respond to customer needs. Our experience is that there has been too little customer-facing competition and innovation in personal and SME banking, as might be expected from a banking oligopoly, with little pressure from smaller competitors which do not enjoy the benefits of scale but have to compete by meeting customer needs for appropriate products and good service.
27. As a result of the substantial consolidation in UK banking which has occurred in the last twenty years, there is now a high level of concentration in retail banking[13] in the ownership of large universal banks, and much less choice for customers seeking an alternative to the large incumbents, except Nationwide and the UK subsidiaries of National Australia Bank, and much smaller new entrants such as Virgin Money and Tesco Bank.
28. The process of consolidation was extended further during the financial crisis, through the acquisition of HBOS by Lloyds TSB, the acquisitions by Santander of Alliance & Leicester, Bradford & Bingley assets and the RBS retail banking assets sold as a result of the EU directive, and the acquisitions of Dunfermline Savings Bank, and the Derbyshire, Portman and Cheshire Building Societies by Nationwide. We believe that the acquisition of HBOS by Lloyds TSB would not have been allowed except during the financial crisis, and we consider it regrettable that the RBS assets were sold to Santander rather than used to establish a credible competitor to the large incumbents – as happened after the Competition Commission prevented the proposed acquisition of Abbey National by Lloyds TSB.[14]
29. We observe that the five large incumbent banks now enjoy a position such that, in good times, they will benefit from having consolidated and so eliminated almost all effective competition, while, in the bad times, they will benefit from being “too big to fail”.
30. During and since the financial crisis, attention has inevitably been focused on financial stability. We believe that more attention should now be given to competition, to reverse the consolidation trend and to avoid perpetuation of the dominance of UK retail banking by a small group of banks, each of which is “too big to fail”. We are therefore pleased that the Independent Commission on Banking is considering the possible interaction between competition and financial stability, and possible structural reforms.

[10] “A new approach to financial regulation: judgement, focus and stability” HM Treasury, July 2010, page 24
[11] “Once a bank began the process, competitive pressure ensured others followed. In fact, it is fair to say that a major impetus to financial innovation in the last decade was the incentive to circumvent the capital adequacy regulation embedded in the Basel accords.”, Don’t be fooled again, 2010, Chapman, page 196
[12] “What matters is not competition *per se*, but competition to provide what customers want. Where markets are not functioning well, suppliers’ incentives can be distorted, and competition can be a mixed blessing – suppliers may compete amongst themselves, but not necessarily on issues that customers care about” Independent Commission on Banking Issues Paper, September 2010, page 20
[13] Independent Commission on Banking Issues Paper, September 2010, pages 9-10
[14] Lloyds TSB Group Plc and Abbey National Plc: A report on the proposed merger, Competition Commission, 2001

31. We have already engaged with the Independent Commission on Banking and will discuss with them our experience and views in relation to competition in UK personal and SME banking. These were set out in our submission to the OFT Review of Barriers to Entry, Expansion and Exit, and can be summarised briefly as follows:
    - We believe that there are significant barriers to entry and expansion by a new entrant in personal and SME banking.
        - In the core banking product, current accounts, "free banking" (subsidised by "insufficient funds" charges) makes it difficult for a new entrant to compete on price or by innovation
        - It is difficult to enter SME banking without a reputation in it and without credit analysis made possible from current account relationships
        - We believe that new entrants are generally required to adopt more conservative approaches to capital and liquidity than large incumbent banks
        - "Too big to fail" banks are gaining ongoing advantages such as significantly lower funding costs than would be the case without their actual or implicit Government guarantees
    - For these reasons, despite Virgin Money's enthusiasm and aspirations, we believe that it will take some time for a new entrant to achieve reasonable scale in personal and SME banking, and that the large incumbents will have time to respond to any emerging threats
    - So we believe that it is desirable for a new entrant wishing to offer the core relationship banking products of personal current accounts and SME banking services to accelerate its entry through the acquisition of relevant retail banking assets
    - But there are no longer any small banks or converted building societies to buy. Other than Nationwide, which is too large for a new entrant to acquire, building societies have limited regional networks and so do not support the national aspirations of Virgin Money. So an acquisition could only be possible as a result of the disposals required by the EU directives, or by other such divestitures
32. In addition to any immediate reforms suggested by the Independent Commission on Banking, we believe that there will be an ongoing need to regulate competition as well as financial stability more effectively than has been the case in the past.
33. The failure of the OFT and Competition Commission to make an impact in banking, despite the merits of their enquiries, and despite their undoubtedly good intentions, is illustrated by the list of banking reviews set out in the Independent Commission on Banking Issues Paper.[15] An isolated positive outcome was preventing the proposed acquisition of Abbey National by Lloyds TSB. The Competition Commission did impose financial remedies in SME banking, but dropped them after a few years. At the less successful end of the list, the review of credit card interchange fees has been going on for ten years, despite the obvious monopoly positions of Visa and MasterCard. The OFT's conclusion from its prolonged investigation into personal current accounts was overturned by the Supreme Court (despite the apparently unfair cross-subsidy in insufficient funds charges), perhaps because the OFT focused, or was required by its constitution and powers to focus, on legal arguments rather than on common sense and judgement. Even worse, in relation to the proposed acquisition of HBOS by Lloyds TSB, the OFT was powerless to act, although it expressed concerns that the transaction might lead to a significant lessening in competition.[16]

[15] Independent Commission on Banking Issues Paper, September 2010, page 24

[16] "There is a realistic prospect that the anticipated merger will result in a substantial lessening of competition in relation to personal current accounts (PCAs), banking services for SMEs and mortgages", OFT advice on the proposed Lloyds TSB/HBOS merger, 31 October 2008

34. We believe that it may be better to adopt a more specialist approach to competition in banking because of its unique aspects of long-term products, high concentration and systemic risk. We also suggest that consideration of competition issues should not be a subsidiary issue (requiring it to be considered on a “have regard to” basis), but an issue of equal importance, to be incorporated in the new structure for regulating banks and to be applied with the same degree of judgement as is intended for financial stability.
35. While completing this submission, we note the announcement on 14 October that the OFT and Competition Commission will be merged. Although this has been presented by the media as a cost-saving initiative, we hope that, as for financial stability, the opportunity will be taken to ensure that the integrated competition body has appropriate and clear objectives, and the tools to achieve them. Also, as in the new approach to financial regulation, we suggest that there should be recognition of the need for common sense and judgement, not just compliance with rules and processes. We specifically suggest that a public interest test should be reintroduced, and regard this as equivalent to the need for a "true and fair view" statement by auditors.

Conclusion

36. We hope that you find these comments useful. We would be happy to meet you to discuss them and related issues, and we would be happy to provide written submissions on any of the specific questions where you consider that a response from Virgin Money would be helpful.

I am responding on behalf of Waltons Insurance Brokers Ltd

Consumer Protection and Markets Authority (CPMA)

We would continue to support the Regulatory Objectives of the FSA i.e.

- Market Confidence
- Public awareness
- Consumer Protection
- Reduction of financial crime

We also would continue to support the **high level** Principles for Business e.g. that a firm must arrange adequate protection for clients' assets when it is responsible for them.
We also would continue to support the Treating Customer Fairly initiative, market led solutions such as the Contract Certainty Code of Practice, and the Financial Ombudsman Service.

However we would like the CPMA to

- Adopt a more principles based approach to the regulation of the sale and administration of 'low risk' general insurance products by clearly differentiating between the requirements for private consumers and commercial businesses and between low and high risk products.
- Adopt a more rules based approach to claims management (submission, investigation and settlement) for consumers and commercial customers - consistent with the FSA's TCF principles
- Work with the British Insurance Brokers Association and other trade bodies to understand the general insurance trading environment to ensure the new regulatory regime can be easily understood and fully supported by small as well as large businesses in our sector.
- Remove any anomalies, contradictions and duplications between this regulatory regime , Accountancy Regulations, Companies House Regulations, other UK Laws (e.g. relating to Financial Crime) and recent Court Decisions (e.g. regarding unfair contract terms, duty of disclosure etc).

The reasons for our observations are as follows:

Although the stated aim of the FSA was to adopt a risk based approach to regulation this has not been evident in the detailed rules and guidance.
The emphasis appears to have been to heavily regulate sales processes but adopt a lighter touch to claims processes. This seems inconsistent with customers' actual interests.
There appears to have been a lack of real understanding about the role of the general insurance intermediary and the complexity or lack of complexity of different business models.
From our perspective this 'One Size Fits All' approach has led to increased costs with no obvious customer benefit. E.g.

- FSCS fees for general insurance intermediaries increasing because of the need to fund Payment Protection Insurance miss-selling.
- Capital Resource Requirement for holding of client's money not appearing to fairly reflect the risk of a general insurance intermediary failure to customers.
- Increased documentation and record keeping.
- A rule book/FSA Handbook that is difficult for a small business to interpret without the help of Compliance Consultants and without reference to other regulations.

Helen Graham ACII
Compliance Officer
Waltons Insurance Brokers Limited
A Founder Member of the Willis Commercial network
We are authorised and regulated by the Financial Services Authority

Web: www.waltonsinsurance.com
Registered Number: 3671217

A new approach to financial regulation

DATE: 20 October 2010

FROM: Dominic Lindley, Which?

EXECUTIVE SUMMARY

1. Whilst the major focus has understandably been on the failure of the tripartite system to deliver effective prudential regulation, there have also been serious flaws in the FSA's approach to conduct of business regulation. This has led to a failure to deliver sustained improvements for consumers and a number of major problems surrounding issues like Payment Protection Insurance (PPI), endowment mortgages and bank charges. These failures cost consumers and the industry billions of pounds and damaged consumer confidence.

2. Alongside changes in structure we need fundamental changes to the approach taken in consumer protection, macro and micro prudential regulation. In summary, we believe that the measures we are proposing would lead to a more effective, efficient and accountable regulator.

Consumer Protection and Markets Authority

3. The ultimate purpose of regulation is to ensure that markets work well for consumers. In order to achieve this aim we believe the following measures should be adopted.

- The objective for the CPMA should be to ensure a fair, transparent and competitive market in financial services, with particular focus on protecting consumers and ensuring market integrity. We are concerned that an objective focused on ensuring "confidence" could have unintended consequences. For example, it may discourage the regulator from publicising poor practice or drawing attention to areas where markets are not working well for consumers.

- The CPMA should have a duty to promote effective competition and ensure that competition is effective at protecting and benefitting consumers.

- When discharging its functions the CPMA should 'have regard' to factors including the price and value for money of financial products and services, the need to proactively disclose information and promoting public understanding of the financial system and financial inclusion.

- The CPMA should take a stronger approach to enforcement with higher financial penalties and action against individuals. It should have powers to regulate products and tackle the root causes of consumer detriment such as

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remuneration structures which encourage mis-selling. It should have the powers to challenge unfair charges (such as those on unauthorised overdrafts). It should make greater use of market testing and mystery shopping to test the actual outcomes being received by consumers.

- The Board should contain a number of individuals with experience and knowledge of consumer issues.

- Proper accountability can only come alongside improved transparency, so it is very important that the legislation does not constrain the CPMA. Section 348 of FSMA should be removed and there should be a presumption in favour of disclosure of information by the regulator.

Coordination between the CPMA, PRA and FPC

4. Splitting responsibility between three different regulators does not remove the conflicts which can exist between different functions, but merely externalises them. We do not believe that the PRA should be given primacy over the CPMA. To permit the PRA to prevent the CPMA taking a firm-specific conduct decision sends a dangerous message to the industry that only firms which are small enough to fail without causing damage to financial stability will be forced to bear the full consequences of mistreating consumers.

Prudential Regulatory Authority

5. The current supervisory approach to prudential regulation is not effective. The significant implicit subsidy received by the banking sector has eroded market discipline, distorted competition and encouraged banks to intertwine highly leveraged investment and wholesale banking activity with essential retail banking activities and the payments system. Responsibility for prudence must lie with the banking institution, its management, shareholders and debt providers and not be delegated to regulators. Stability is not created by trying to prevent failure, but by enabling firms to fail in a controlled way. The regulator must change its approach from attempting to prevent failure in all circumstances to ensuring that banks can fail, but without significant harm to their customers, vital banking services or the economy.

Macro-prudential regulation (Financial Policy Committee)

6. We support the introduction of the Financial Policy Committee and note the implications of the use of macro-prudential tools such as changing Loan-To-Value limits and capital requirements on consumers. It is important that these issues are tackled prior to the start of the operation of the FPC.

Consumer Protection and Markets Authority

10 The Government welcomes respondents' views on:
• whether the CPMA should have regard to the stability of firms and the financial 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;
• whether there are any additional broader public interest considerations to which the CPMA should have regard.

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

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

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

7. Which? believes that structural changes to regulatory authorities will not, on their own, address the root causes of poor regulation. Major changes in approach are needed to ensure financial services consumers receive adequate protection from the new Consumer Protection and Markets Authority.

8. The previous approach to regulation failed to deliver sustained improvements for consumers. It was an approach that was too reactive and failed to put in place the right incentives for firms, make competition work for consumers or ensure that there was a credible deterrent against poor practice. Instead of tackling the root causes of consumer detriment, the regulator sought to control the sales process. It did not focus on (or indeed do much to measure) the outcomes received by consumers. There was an emphasis on disclosure of information, rather than ensuring that consumers could understand and act on this information. Indeed, the volume of information provided can deter consumers from using it effectively. The previous approach led to a number of major problems surrounding issues like Payment Protection Insurance (PPI), endowment mortgages and bank charges. These failures cost consumers and the industry billions of pounds and damaged consumer confidence.

9. The ultimate purpose of regulation is to ensure that markets work in the interests of consumers. The CPMA should work to ensure that market forces can work more effectively in the financial services market so that companies which treat their customers fairly and offer good value for money products gain business at the expense of firms which do not. Similarly, it must be made clear to firms, their management and shareholders that a failure to treat customers fairly will have a significant detrimental effect on the firm's reputation and bottom line.

10. Over the past year we have seen a number of welcome changes to the FSA's approach including a move from a purely reactive to a proactive approach and a greater willingness to tackle the root causes of consumer detriment. We are keen to ensure that this new approach is carried across to the new regime and that the CPMA is given the mandate, powers and tools to deliver improvements for consumers. In order to achieve this we believe the following issues must be addressed:

Mandate and objectives

11. We believe that the objective for the CPMA should be to ensure a fair, transparent and competitive market in financial services, with particular focus on protecting consumers and ensuring market integrity. We have concerns about the unintended consequences that could result from the current proposed primary objective relating to "ensuring confidence" - for example, it could discourage the regulator from publicising bad practice or drawing attention to areas where markets are not working properly for consumers. As a result we believe the Government should reconsider the objective it has set out.

12. Whatever its primary objective, we believe the CPMA should have a duty to promote effective competition. The CPMA should focus on ensuring that competition is effective in protecting and benefiting consumers. We believe that the shortcomings of competition regulation under the Financial Services and Markets Act are at best, wholly inadequate and at worst detrimental to the competitive landscape of the financial services sector.[1] The financial crisis has seen a significant increase in the concentration of key retail banking services. Unsurprisingly, banks have used this increase in concentration and reduction in competition to expand their margins at the expense of consumers.[2] The CPMA should be given the necessary powers to

[1] Please see Annex 1 for an explanation of the shortcomings of Competition Regulation under the Financial Services and Markets Act 2000. This text is based on the analysis conducted by the *Future of Banking Commission* and has been updated to include further examples.

[2] For further details please see our response to the Treasury Select Committee's inquiry into competition and choice in the banking sector, http://www.publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/memo/banking/m20.htm ; Also see Bank of England, Quarter 2010 Q3, 'Understanding the price of new lending to households'

regulate the sector to achieve an improvement in effective competition, including the ability to apply specific licence conditions to banks and exercise competition and consumer protection legislation. Its competition powers would be concurrent with the competition powers of the OFT and will enable the regulator to make market investigation references to the competition commission. This was a key recommendation of the *Future of Banking Commission*.[3]

13. In order for the CPMA to act as a strong consumer champion, we support the inclusion of a number of "have regards" including:

- The price and value for money of financial products and services: The price and 'value for money' which consumers receive from financial products and services is a key component of fairness. The inclusion of this factor would have led to far stronger action by the FSA with regard to PPI – which our own analysis demonstrated was an uncompetitive and over-priced product. The CPMA would also ensure that consumers can be confident that once they have entered into a contract, they will not be subjected to any unexpected charges or, if they are, such charges are fair and proportionate. The loss of the Supreme Court case on unauthorised overdraft charges has exposed significant gaps in the ability of regulators to tackle unfair charges so we believe the CPMA should be given the authority and powers to challenge these charges and assess whether they are fair and proportionate. We outlined a possible approach in our submission to the European Consumer Rights Directive and also raised this issue in our response to the Treasury Committee's inquiry into Competition and Banking.[4]

- The need to proactively disclose information which might influence a consumer's decision to engage in a commercial relationship with a financial services company: there should be a presumption in favour of disclosure and information should only be withheld where its release would damage the interests of consumers.

- Promoting public understanding of the financial system: the regulator should ensure that consumers have, understand and can use the information they need to make decisions about financial products and services

- Promoting financial inclusion: This should recognise that in the same way as

[3] For further information please see Chapter 3 of the Future of Banking Commission report, http://commission.bnbb.org/banking/sites/all/themes/whichfobtheme/pdf/commission_report.pdf

[4] http://www.which.co.uk/documents/pdf/consumer-rights-directive-allowing-contingent-or-ancillary-charges-to-be-assessed-for-fairness-bis---which---consultation-response-226521.pdf ; http://www.publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/memo/banking/m20.htm

utility services, access to basic financial services are essential for consumers to properly participate in society.

14. We support the removal of the need for the regulator to have regard to the international character of financial services and markets and the desirability of maintaining the competitive position of the UK and the desirability of facilitating innovation. We do not feel these are suitable objectives for a regulator tasked with consumer protection. The inclusion of "innovation" presupposes that innovation in financial services is always beneficial for consumers and markets. In actual fact, innovation of product design can frequently involve increasing complexity or products which benefit the industry not consumers. The need for regulators to have regard to "international competitiveness" creates a conflict of interest which tends to support the status quo and be insufficiently challenging to the industry.

Supervision and enforcement

15. We welcome the intention that the CPMA will take a strong approach to enforcement to ensure credible deterrence. In order to achieve this we believe the following changes are necessary:

- Financial penalties will need to be significantly higher than those imposed by the FSA.

16. Examples of fines in Payment Protection Insurance (PPI) cases have shown the level of fines issued were minute in comparison to the revenues firms generated from mis-selling – in the case of the January 2008 fine for HFC Bank Limited it represented less than 0.4% of sales revenue.[5] Even after the FSA had decided to significantly increase the level of penalties it imposed for PPI mis-selling, the fine levied on Alliance and Leicester represented less than 3% of the revenue they gained from selling the product.[6] It is unsurprising that the FSA's regulatory activity in the market for Payment Protection Insurance has not had the desired outcome in ensuring that customers are treated fairly. We would suggest the CPMA looks at the example of other regulators who levy substantially higher fines for consumer abuses. Under the Competition Act 1998, the OFT has the power to levy a financial penalty of up to 10% of global turnover of the business involved. OFWAT and OFGEM have similar powers. British Airways was fined £121.5 million for collusion over fuel surcharges.[7] Argos and Littlewoods were fined a total of £22 million for fixing the price of toys and games.[8] OFWAT fined Severn Water £35.8 million for mis-reporting information and providing

[5] http://www.fsa.gov.uk/pubs/final/hfc_bank.pdf

[6] http://www.fsa.gov.uk/pubs/final/alliance_leicester.pdf

[7] http://www.oft.gov.uk/news/press/2007/113-07

[8] http://www.oft.gov.uk/news/press/2003/pn_18-03

sub-standard service.[9] Shareholders will only be incentivised to put pressure on senior management to ensure customers are treated fairly when financial penalties represent a significant proportion of the revenue gained from selling a product.

- Greater action should be taken against the senior individuals responsible.

17. Senior management have to be clear that breaching regulations will result in serious consequences for themselves and for their firm's reputation and bottom line. The CPMA should send a clear signal that it will take action against individuals, including greater use of orders prohibiting the individuals from working in the financial services industry.

Remuneration systems

18. The CPMA should move from a purely reactive approach to one which seeks to tackle the root causes of consumer detriment. In our view, remuneration systems linked to sales targets create a conflict of interest between the consumer and the firm. They encourage banks to recommend courses of action which result in the sale of a product, rather than that which is most suitable for the customer. They also contribute to mis-selling. For example, advisers at Alliance and Leicester received six times as much bonus for selling a loan with PPI as they did for selling a loan without PPI.[10] The CPMA should prohibit remuneration and commission systems for both frontline staff and senior management which encourage mis-selling.

Effective redress

19. In the past ten years we have seen substantial detriment caused to consumers in a number of areas including mortgage endowments and Payment Protection Insurance. The impact of these problems on consumers has been compounded by the slow response of the industry and regulators. Excessively long timescales, poor complaints handling and inadequate redress have become all too common. The CPMA should adopt an effective redress system which improves the incentive for firms to treat customers fairly. Two approaches which should be adopted are:

- Past case reviews

20. The CPMA must show greater willingness to utilise the s404 powers to require firms to actively review past sales of a particular financial product where detriment has occurred. This would be a similar process to a 'product recall'. Product recalls are

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[9] http://www.ofwat.gov.uk/regulating/enforcement/prs_pn2108_svtfne020708
[10] http://www.fsa.gov.uk/pubs/final/alliance_leicester.pdf

a practice used across a number of sectors (from food to cars and other consumer products) to deal with deficient products. In these sectors, firms will typically stress test products and institute national or local recalls in response to defects.

- Collective redress

21. The CPMA should introduce an improved method of collective redress which would allow a collective claim to be made on behalf of all those consumers who are adversely affected. This could have benefits for consumers in improving access to redress while reducing the administrative cost for firms and the regulator of dealing with individual cases. We believe that the Courts should have the power to ensure that claims could be done on an opt-out basis.

Conduct risk

22. The CPMA should preserve the FSA's Conduct risk division which is aimed at the identification of emerging risks before they crystallise and cause major consumer detriment. We also recommend that the CPMA should make greater use of market testing and mystery shopping to test the outcomes received by consumers.

23. In addition, there should be a Committee introduced with members from the CPMA, OFT, FOS to share information about potential risks and the merits of dealing with the issue through a complaints-led approach or by regulatory action by the CPMA. This Committee would gather evidence from consumer and industry groups and set a timetable for investigation. This proposal would enhance the current 'wider implications' process. At the same time, we would favour a move towards a more formal process (along the lines of a supercomplaint process) which allows consumer bodies to raise potential issues with the CPMA and for the CPMA to publicly report on action taken.

Product regulation

24. We believe that the CPMA should embrace the role that product regulation can play in addressing conflicts of interest, disciplining markets and aligning the interests of producers with consumers. In many markets, competition provides an effective force in shaping the products on offer and ensuring they meet consumers' needs. However, effective competition relies on consumers being able to make informed choices, based on an ability to compare competing products with each other. This should cause firms which offer poor value and poor quality products to lose business at the expense of their competitors. However, this is frequently not the case in the financial services sector, where consumers' ability to make informed choices are hindered by a combination of their lack of financial capability, product complexity,

incomplete or unclear contracts, the length of time between the purchase of a product and discovering whether it has worked and a lack of transparency in the design and marketing of financial products.

25. Product regulation could be used by the regulator to address three key issues:

- Ensure minimum standards for key products: There are certain products, such as current accounts and protection products, that consumers need access to. We believe the regulator should ensure that any such products meet minimum standards. We would draw a parallel with motor insurance where all products on sale must meet minimum legal requirements, and consumers then have the option to add on additional 'bells and whistles'. A further example would be to set the default standards for some products in the interests of consumers – this could include ensuring that consumers are able to opt-out of unauthorised overdrafts for current accounts. The regulator may also take steps to ensure that information disclosure is on standard terms, enabling consumers to easily compare products. It could also take steps to introduce industry-wide standards such as portable bank account numbers for current accounts.

- Minimise the toxic aspects of products and in some cases prohibiting a particular type of product or specific product (for example single premium PPI): Product regulation can play a valuable role in limiting the harm that certain products can cause.

- Ensure the availability of 'vanilla' products: Experience has shown that the financial services industry alone will not develop simple, good value for money products which meets consumers' needs. We believe the regulator should pursue the idea that providers and intermediaries should offer simple, straightforwardly priced 'vanilla' products alongside their additional product offerings.

Governance and accountability

26. Further steps need to be taken to ensure that the regulator is subject to greater accountability than is currently the case with the FSA. It is essential that the mechanisms for greater transparency which we recommend below

27. We welcome the intention to make the CPMA subject to audit by the NAO. The regulator should also be accountable to the Parliamentary Ombudsman. We support the continuation of the Consumer Panel. The Consumer Panel must be properly funded and resourced. It is important to recognise the inherent imbalance in resources between those who lobby on behalf of the industry and those who lobby on

behalf of consumers.

28. In addition to increased oversight by the Treasury Committee, we believe it would be beneficial if the regulator made itself more available to scrutiny. This could take the form of a monthly question time where senior figures and board members were required to take questions from key stakeholders.

Board structure

29. In the past, the fact that 10 of the 12 members of the FSA board had been currently or previously employed by the industry raised the risk that only the prevailing mindset of the industry gained credence in Board deliberations. There was a clear preference to codify existing industry practice instead of asking searching questions about whether markets were working efficiently and in the interests of customers.

30. It is clear that alternative perspectives are needed and the Board of the CPMA needs to be more diverse, with an increase in consumer representation and Board members with experience and knowledge of consumer issues. It is important that all Board members are independent of the industry and should only be allowed to participate in decisions where they are free from conflicts of interest.

31. We would also like to see greater transparency around the agendas, forward plan and minutes of board meetings to provide full information about when the Board is taking key decisions - though we acknowledge that financial stability considerations may occasionally limit the amount of information which can be disclosed in advance. It would also be useful to hold at least one public board meeting a year – where individual board members would take questions from stakeholders.

Regulatory transparency

32. Proper accountability can only come alongside improved transparency. We believe that regulatory transparency could have a powerful effect towards incentivising firms to improve their practices. It also helps the industry as it ensures that, if scandals do arise, offenders are identified and the entire industry is not tarred with the same brush.

33. The main roadblock to greater regulatory transparency is Section 348 of FSMA that prevents the FSA from disclosing information it receives in the discharge of its regulatory duties, except in certain defined circumstances. In addition to the problems involving its interpretation by the FSA, it also places substantial barriers to organisations making Freedom Of Information (FOI) requests to the regulator. It allows the regulator to reject FOI requests without being subject to a public interest

test. Which? has submitted a number of FOI requests to the FSA asking for the names of mortgage lenders which had performed poorly in the FSA's thematic work. We believed that consumers had a right to know which lenders were treating customers unfairly and that this information should also be shared with the Court judges hearing repossession requests from these lenders. The FSA rejected our request and offered a number of excuses including that it would harm the lenders brand and reputation, would undermine firm's willingness to engage in a dialogue with the FSA and to provide the FSA with information and the restrictions imposed on it by Section 348 of FSMA.[11] The FSA has also refused to disclose the instructions which it had given to firms which had been fined for mis-selling PPI, stating that as the instructions it gave to the firms would invariably involve information received from the firm, they would also not be able to disclose it due to Section 348 of FSMA. A culture of secrecy harms accountability and only benefits those firms breaking the rules.

34. Section 348 should be removed and the text of the future legislation should reflect the minimum restrictions on disclosure required by EU directives. We believe this to only consist of a requirement for the FSA not to disclose confidential information it has received from other EU regulators.

35. The actual practice of the CPMA would be influenced by a clear mandate to disclose information where it might help the CPMA achieve its objective of a fair, transparent and competitive market in financial services or where it might influence a consumer's decision to engage in a commercial relationship with a financial services firm.

36. In addition to the legislative changes, we would like to see further transparency in seven key areas.

- **Thematic work**: We believe the regulator should disclose the firm-specific results of the thematic work it undertakes. The current failure to name those firms performing poorly means that consumers are kept in the dark and firms are able to get away with not treating their customers fairly without suffering any practical penalty.

- **Misleading financial promotions**: We would like the regulator to take a similar approach to the Advertising Standards Authority (ASA) and introduce a Financial Promotions Register which shows where the regulator has received complaints and where a firm has been required to withdraw or amend a

[11] For further details pleas see Which? written evidence included in the Treasury Committee's Fifteenth Report of session 2008-09, 'Mortgage arrears and access to mortgage finance", (Ev 63); http://www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/766/766we06.htm

misleading financial promotion. This would provide a powerful incentive for firms to improve standards, would help draw the attention of consumers who may have responded to the misleading promotion, and could motivate more consumers and consumer groups to report adverts they find misleading. As an example of the drawbacks of the current system, when we submit a complaint about a particular financial promotion to the FSA we do not receive any feedback or adjudication which says whether the FSA agreed that the promotion was misleading and whether the company was required or to amend or withdraw the promotion. We contrast this with the feedback we receive when we submit a complaint to the ASA concerning the potentially misleading health claims made in an advert for Nutella chocolate spread.[12]

- **Price data**: We would like the regulator to require firms to provide the relevant price data on their products, and use this data to publish comparison tables. This will make it easier for consumers to shop around to get the best rate and spot when they are getting a bad deal, and for organisations like Which? to warn them about products to avoid. The regulator should also ensure that firms provide information to consumers about the ongoing costs of their products and bank accounts. This could be in an electronic form, which consumers could use to determine whether they could get a better deal elsewhere.

- **Complaints data**: The FSA has moved to publish complaint numbers for individual firms which receive more than 500 complaints every six months. However, we believe that the CPMA should go further and publish all of the complaints statistics it receives from all firms online. As these are already collected by the regulator electronically, there should be no additional costs for individual firms.

- **Own-Initiative-Variation-of-Permission**: This would ensure that in a situation where the CPMA has concerns about a firm and varies its permission to undertake specific activities, that this is made public. This could include restrictions such as not allowing the firm to accept new business, but can also include actions such as requiring firms to contact customers who have replied to a misleading financial promotion.

- **Warning and enforcement notices**: The CPMA should publish details of the firms which it has referred to enforcement.

- **Redress schemes**: The CPMA should publish the names of the firms which

[12] http://www.asa.org.uk/Complaints-and-ASA-action/Adjudications/2008/2/Ferrero-UK-Ltd/TF_ADJ_44078.aspx

are subject to the scheme, list what activity the firms are undertaking, the text of all letters used in customer contact exercises, the criteria the firms are using to calculate redress, the response rates to any customer contact exercise and the amount of redress paid.

The Financial Ombudsman Service

37. The existence of an effective consumer redress system is vital to ensuring confidence in the financial system and to facilitate the smooth running of the industry. Which? as an organisation has redress for consumers as a core principle. We support alternative dispute resolution systems as a cost-effective alternative for both consumers and firms. Which? believes that the FOS is effective at providing a method of dispute resolution which is fair to both consumers and firms. The FOS ensures a level playing field between firms and consumers and provides an effective alternative to the court system. It is important that the reforms to regulation do not downgrade the role of the FOS. We would oppose the introduction of any fee for consumers to access FOS.

Interaction / Coordination between the CPMA, PRA and FPC

38. It was clear from our discussions with a consumer group from a country that already operates this model that splitting responsibility between different regulators does not remove the conflicts which can exist between different functions, but merely externalises them. There should be coordination arrangements but we do not believe that the PRA should be given primacy over the CPMA. If a firm-specific conduct decision would impact financial stability by leading to a failure of a bank then the PRA has clearly not been undertaking its remit effectively. In the current environment we also do not believe that a decision to prevent the CPMA from taking a firm-specific decision which would lead to the failure of the firm would or should ultimately lead to the continued existence of that firm. If a firm has broken the regulations and/or common law and consumers have suffered financial detriment then it will not be possible for the PRA to extinguish the legal liability of the firm. To permit the PRA to overrule the CPMA also sends a dangerous message to the industry that only firms which are small enough to fail without causing damage to financial stability will be forced to bear the full consequences of mistreating consumers. We believe that the Government should publish some scenarios showing the circumstances which it believes might lead to the PRA overruling the CPMA in a firm-specific conduct decision.

39. We acknowledge that there will need to be formal information exchange between regulators and that the FPC will need to both give directions and to make recommendations to the PRA and the CPMA regarding the regulatory tools which will

need to be deployed in pursuit of macro-prudential policy. Wherever possible we believe that these instructions and recommendations should be made public.

40. There will also need to be a coordinated approach between the CPMA and PRA for breaking up any banks which pose a systemic risk or harm competition. Under the new regime there would be two possible reasons for restructuring or breaking up a bank. For example, the competition authorities may have concerns about the dominant market share of one individual bank in the mortgage market. The prudential regulator could have similar concerns regarding the dominant position of that bank on the basis that it would make it impossible for the bank to fail without causing significant damage to the economy.

41. The CPMA will also need to provide input to the PRA on the preparation of 'living wills' to ensure that these cover how customers will be treated and provide sufficient protection for customers' interests.

42. The PRA and CPMA will need to work closely together in making their respective decisions about the granting, amending or withdrawing permissions for particular activities. For example, permission to be active in the mortgage market could include activities which would be of interest to the PRA (mortgage lending) and the CPMA (advising and arranging mortgage contracts).

43. The supply chain for financial services is complex and it is possible for a firm designing a product to have no contact with consumers (by distributing the product through third parties). We would like clarification about where the regulation of the product design phase would be located if the firm was not regulated by the CPMA.

The Financial Services Compensation Scheme

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

44. It may be advantageous for the CPMA to make all of the rules relating to the levies for the FSCS. Regardless of the decision taken on rules, we strongly believe that in the interests of economy and efficiency a single organisation should continue to administer all claims for compensation.

45. The CPMA should be responsible for ensuring that firms make the limits of the compensation scheme clear to consumers. The CPMA should also prevent the misleading promotion of products which claim to provide a guarantee of capital, but which are not covered by the Compensation Scheme.

46. The PRA will also need to work with the FSCS on 'living wills' and reforms to resolution procedures to ensure that depositors rank above bondholders. There will also need to be a close working relationship between the PRA and the FSCS as prompt/instant payment of compensation will be important in ensuring the continuity of essential banking services. For example for current accounts, it is unacceptable for consumers to receive a cheque within seven days and then be expected to open another current account. A seamless transition of banking services is required.

Prudential Regulatory Authority

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

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

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

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

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

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

<u>Problems with the current approach to prudential regulation</u>

47. Which? is concerned with the current approach to regulation of banks and the legacy of the Government's intervention during the financial crises. These have significant effects on the prospects for competition in retail (and likely SME) banking by creating:

- Distortionary subsidies, direct through state aid bailouts and indirect by reducing funding costs, to the largest market incumbents thereby strengthening their market power; and

- No effective regime to enable market exit by failing banks (whether due to poor management or dissatisfied customers) while preserving financial stability of the economy as a whole.

48. These concerns relate to the public policy for regulation of banks and the role of UKFI in managing taxpayers' stake in those banks that relied upon state aid to avoid failure. Further reform should also be taken in the overall approach to regulating banks: too often regulators are held accountable for banks' decisions that create instability or put consumers at risk and those same banks remain in business regardless.

Regulation – implicit subsidy

49. Which? established a Commission into the Future of Banking early in 2010, and received evidence from key players amongst banks, regulators and government. Evidence to the Commission made it clear that the banking industry enjoys a significant public subsidy, in the form of tax payers' funds used to protect failing banks from insolvency. Lord Myners noted that "the banking industry, because it's been underwritten implicitly against failure, without paying a premium, has enjoyed a huge subsidy". This was evident in the approach to bank failure during the crises but also marked a long-standing trend, when dealing with risks to financial stability, of preserving the status-quo by state aid or by merger.

50. This subsidy arguably distorts decision making by banks, fostering riskier behaviour than would otherwise be acceptable, while enabling those banks to raise funds more cheaply. For those banks requiring taxpayer support, it has been necessary to support the whole bank, not just the assets and liabilities linked to essential banking activities such as the payment transmission system or securing customers' deposits. Mervyn King noted to the Future of Banking Commission: "Ultimately the heart of the problem does come down in my view to the inherent riskiness of the structure of banking that we've got, and the difficulty of making credible the threat not to bail out the system, which is what is underpinning the implicit subsidy and creating cheap funding for large banks taking risky decisions."

51. It has been argued that the value of this subsidy, which distorts the cost of capital for banks, has increased over the course of the financial crisis as the implicit subsidy became explicit support, and is greater for larger than smaller banks. For example, Andy Haldane of the Bank of England estimates that the subsidy for the biggest 5 banks in the UK amounted to £50 billion for the period 2007-09, representing about 90 per cent of the total implicit subsidy available to the banking industry. In its submission to the Future of Banking Commission Virgin Money estimated private equity investors demanded a 10 – 13 per cent higher cost of capital from new entrants

than from the largest incumbents: effectively double the cost facing the largest banks.

52. This subsidy results in a significant moral hazard. It fundamentally erodes the ability of small or new entrant banks to become serious challengers to the large, established incumbents. As a result market discipline, the key mechanism of competitive markets, is made ineffectual: good banks are unable to drive out the bad, while big banks remain big. By encouraging high and excessive leverage, the implicit subsidy actually increases the likelihood of taxpayers being forced to step in and support the banking sector. It also encourages banks to intertwine highly leveraged investment and wholesale banking activities with essential retail banking activities and the payments system.

<u>Powers, function and approach of the PRA</u>

53. Whilst we accept the criticism of the previous regulatory approach to prudential regulation, expecting a move to a more judgement-focused approach with regulators exercising judgements about the safety and soundness of firms through greater supervision to lead to greater outcomes poses two particular problems. Firstly, because the increasing trend to put reliance on the regulator's supervision of compliance with international capital adequacy standards, such as those set by the Basel Committee on Banking Supervision, has created perverse incentives for banks to game the rules. Secondly, judgement-based supervisory regulation can all too easily turn into 'shadow management' and there is a limit to how effective this approach can be to regulating individual firms. Supervisory regulators will always be outnumbered by market participants who retain an informational advantage.

54. In his evidence to the Future of Banking Commission, Mervyn King cited the example of Citibank, which still faced near collapse during the crisis despite high calibre management and very close supervision by 'dozens' of regulators embedded within the firm. He note that "I cannot believe that any regulator in the world could honestly pretend that they would do better than what happened [at Citibank], and I think we have to recognise that sometimes things happen which are almost impossible to anticipate, hard to calibrate in advance in terms of how much capital you need to put aside, or how much cash you need to bank, in order to be sure that you won't get into trouble … Having a system that's robust with respect to that seems to me of fundamental importance, and as I understand it, that is exactly what regulators in other industries supplying utilities would encourage us to do".

55. Which? agrees that the lessons of other regulated industries have not been applied to financial services. In other industries, regulators strive to establish the pre-conditions for effective competition. It has always been recognised that for effective competition to be possible, the regulator has to ensure there are specific

arrangements in place which allow firms to fail while ensuring the continuity of essential services. For example, in the Water Industry when Enron acquired Wessex Water, OFWAT imposed conditions including requiring the Board to act as if it was an independent company and prohibited cross-default operations.[13] Their primary objective was not to protect Enron's shareholders, but to ensure that customers would continue to receive an essential service and that the creditors of Enron corporation should have no recourse to the assets of the Water company. The result was that when a combination of fraud and incompetence caused Enron to collapse, the ring-fencing provisions ensured that Wessex Water was able to continue to function and essential services were maintained.

56. The prudential regulator must change its approach from attempting to prevent failure to ensuring banks can fail, but without significant harm to vital banking services or the economy. Stability is not created by preventing failure, but by enabling firms to fail in a controlled way. The PRA would be the guardian of the 'living wills' which banks would be required to produce.

57. Ensuring that banks face a realistic prospect of failure would help improve the accuracy of the pricing of equity and debt to individual banks and help ensure that these more accurately reflect the risks of a specific bank. Responsibility for prudence must lie with the banking institution, its management and debt providers and not be delegated to regulators.

58. The PRA would take pre-emptive steps to:

1) Protect ordinary depositors and retail customers
2) Ensure the continuity of all essential retail banking services
3) In the case of any institution that is too big or otherwise too significant to fail, intervene to restructure that institution such that its failure would no longer present a systemic risk

59. The PRA should have a specific duty to promote competition. This would help support its focus on not preserving the status quo or existing institutions, but creating a market with the realistic prospect of failure. It would also ensure that the PRA does not impose excessive barriers on new entrants, by making them carry higher levels of capital or liquidity than existing banks. It should also have an objective to limit and remove the extent of the implicit subsidy received by the banking sector, which distorts competition and disadvantages new entrants.

[13] For details of the ring-fencing provisions imposed see OFWAT, The Proposed Acquisition of Wessex Water Limited by YTL Power International Berhad, April 2002

60. The PRA should need to "have regard" to the objectives of the CPMA. It will need to work with the CPMA to ensure that 'living wills' and the arrangements for the provision of essential banking services offers sufficient protection for customers' interests. The PRA should take responsibility for monitoring and setting down standards for any remuneration practices which could work against its objectives for the stable and prudent operation of the firms it regulates.

61. We support the proposal that the PRA will not need to "have regard" to the competitiveness of the UK as a location or the need to promote innovation. This is for similar reasons to those explained in paragraph 14.

Governance and accountability of the PRA

62. The consumer panel established as part of the new regulatory function should also monitor, advise and challenge the PRA through its policy development to ensure that it takes into account the interests of consumers. The PRAs rule-making function should be subject to statutory processes which include consultation with the consumer panel. It is important that the PRA is not subject to excessive restrictions on its disclosure of information. Indeed, an approach which involves the active disclosure of supervisory information to the markets would be preferable. *The PRA should be subject to the requirement to hold an annual public meeting.* We welcome the intention to make the PRA subject to audit by the National Audit Office.

Prudential regulation of insurance companies

63. We note that whilst no major UK insurance companies collapsed or required government support due to the financial crisis the position would have changed if the Government had not provided systemic support to the banking system. The continuing fall-out from the problems at Equitable Life demonstrates the substantial consumer detriment which can arise from a failure of prudential regulation. It is important that prudential regulation of insurance companies maintains a focus on protecting consumers. It is also important that the implementation of the new framework does not distract from the vital improvements needed in the regulation of with-profits funds.

Macro-prudential regulation

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?

64. We support the introduction of the FPC to address systemic risk and to implement macro-prudential regulation. Consumers and small businesses have been damaged by a move from 'feast to famine' in the availability of credit. The purpose of systemic risk regulation should be to oversee liquidity and capital standards at the macro level. It should be concerned with the inter-dependence of banks and their exposure to common economy wide shocks that may affect key sectors such as commercial and domestic property. Its role should be to act counter-cyclically, to smooth the credit cycle and to 'take the punch bowl away' when credit growth led asset price bubbles grow unsustainably and threaten to lead to instability. This is not an easy task and the framework should ensure that the FPC has the credibility and expertise to challenge the prevailing consensus and to take appropriate action. We also believe that it would be advantageous for some of the external members of the FPC to have expertise and knowledge of consumer issues.

65. However, we express a note of scepticism about the potential effectiveness of macro-prudential regulation to prevent a financial crisis, not least because of the risks of regulators becoming victims of 'flawed intellectual models' and the incentive for banks to find their way round any targets and rules. Increasing the role of macro-prudential regulation also raises questions about the fundamental purpose of banks and bankers. Bankers acting rationally should restrict credit to sectors of the economy (such as commercial property) which become over-valued.

66. Which? does not have the expertise to evaluate the effectiveness of the different macro-prudential tools proposed, so we have concentrated on their potential impact on consumers. We believe that the potential impact on consumers should be studied before the Treasury before it sets out the precise macro-prudential available to the FPC in secondary legislation. The potential impact on consumers could fall into two different categories:

67. Loan-to-Value limits for residential mortgages: When these are changed they will inevitably lead to a number of consumers being stranded with their existing mortgage provider. For example, if a consumer has just taken out a 95% LTV mortgage and the FPC decides to limit the maximum LTV to 90% then that consumer will be unable to move to a different lender (and unless their mortgage is fully portable, to a different house). It is also likely that a reduction in the maximum LTV would lead to house price falls which would further exacerbate the position of that consumer. Unless mortgage contracts are tightly defined, banks will be able to exploit these captive customers by increasing their margins. There will also need to be consultation about how customers should be treated if they are part-way through the house purchasing process and already have a mortgage agreement in place, but have not yet drawn down the funds.

68. Other capital requirement changes: It is likely that banks will use any changes to capital requirements or risk weights to alter the price paid by existing customers. For example, many terms and conditions will allow banks to vary the contract in response to decisions by "regulators". How any changes to price will be applied and the discretion which firms may use to apply these changes are likely to be relatively opaque to consumers (unlike clear contractual terms which could exist for changes in interest rates to follow a clearly defined and transparent reference rate such as a product where the interest rate tracks the Bank of England base rate). We have concerns that firms may seek to apply these changes unfairly or to exercise unfair contract terms. There will also be conflicting messages for consumers if the MPC is lowering the base rate at the same time as the FPC is increasing capital requirements for particular types of consumer lending. The exact terms of contracts are likely to be issues for the CPMA, but how firms may exercise their discretion may also have systemic impacts if, for example, all banks are confident that they will be able to react to any changes in capital requirements by immediately passing on the costs to existing customers by increasing rates.

Markets and Infrastructure

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

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

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

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

69. We would not oppose the merger of the UKLA with the FRC. This may help ensure that the CPMA's focus on consumer protection is not diluted.

70. The arrangements for the monitoring the 'Payments Council' will need to be clarified following the changes to the responsibilities of the OFT. We were concerned about the slow implementation of the 'Faster Payments' system and the lack of clarity for consumers about whether their bank had implemented the new system.

Crisis Management

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

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

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

71. Please see our responses to the questions on the Prudential Regulatory Authority. These will support the move away from an approach which guarantees the stability of every single banking institution towards one where the banks can fail, but without damaging their customers or the economy as a whole. As noted above, we believe the PRA should have wider powers to require management to take action before a crisis hits to ensure that banks are structured in a way where they can fail.

72. We support the need to take action on the international level. Financial markets are increasingly interdependent and poor regulation in one part of the global economy can damage consumer and economic interests globally.

73. In relation to the debates being undertaken at an international level, we continue to be concerned about the absence of the consumer voice. In partnership with 'Consumers International' – a global federation of consumer groups – Which? is calling for the G20 to establish a new expert group on consumer financial protection.

Annex 1

Shortcomings of Competition Regulation under the Financial Services and Markets Act 2000

Competition regulation under FSMA is, at best, wholly inadequate and, at worst, detrimental to the competitive landscape in the financial sector. The ambit of the FSA is currently centred on the maintenance of market confidence, raising public awareness, the protection of consumers and the reduction of financial crime. While the FSA also has, among its primary duties set out in FSMA, the requirement to have regard to 'the desirability of facilitating competition between those who are subject to any form of regulation by the Authority', FSMA does not give the FSA concurrent competition powers with the OFT, which would allow it to either (a) directly apply competition law or (b) refer markets to the Competition Commission, as is the case for the regulators of other industries. It is clear that the FSA's approach is to avoid putting up further barriers against competition, rather than proactively seeking to improve the degree of effective competition in the industry. Indeed, in some sectors of the market such as with-profits funds, the FSA actually applies different rules to existing firms, compared to any recent or potential new entrants.[14] The inadequate focus on appreciating the benefits which competition can bring can also lead to codifying existing industry practice instead of driving improvements for consumers. For example, instead of improving the ability of customers to switch cash ISAs, the FSA simply required that the banks provide a "prompt and efficient service" and referenced existing industry guidance.

Indeed, in its composition, FSMA gives the impression to market participants in the financial sector that they have a degree of immunity from UK competition law since agreements or conduct by a dominant firm, which would usually breach competition rules, are not subject to enforcement if 'encouraged by any of the Authority's regulating provisions'. This provision of FSMA effectively puts the maintenance of effective competitive markets in the financial sector subordinate to FSA regulation, albeit that European competition law can be applied regardless of this exclusion. Competition law considerations were further disregarded when, in the course of the financial crises, the public interest test for merger regulations was widened to include 'financial stability', allowing the Secretary of State to rule in the case of bank mergers, rather than the OFT or the Competition Commission.

The OFT has some specific responsibilities under FSMA 2000, necessary to compensate for the lack of competition objectives in the FSA's mandate. Section 160

[14] COBS 20.2.20

of FSMA requires the OFT to keep the regulating provisions and practices of the FSA under review, and report any significantly adverse effects to the Competition Commission: a process known as ‘competition scrutiny’. There have been no occasions under current legislation where the OFT has exercised this power. So, while the OFT may be suited to ‘repairing’ or conducting investigations into previous competitive markets, it is not up to the proactive task of regulating vigilantly to make markets in the financial sector more competitive.

This special treatment of the financial services industry sends a clear message to both the regulator and industry that the ‘normal’ rules of competition do not apply.

Annex 2

Payment Protection Insurance mis-selling

The mis-selling of Payment Protection Insurance (PPI) is an example of how a poorly functioning market, and a failure to intervene at an early stage to fix it, can disadvantage customers. PPI is designed to cover your debt repayments if you can't work – for example, you become ill or have an accident, or you are made redundant. It is sold alongside loans, mortgages, credit cards and store cards. In the past decade, PPI has been subject to widespread mis-selling, and this has resulted in millions of consumers holding expensive insurance they would never be able to claim on.

PPI offers a clear example of a poorly functioning competitive market, as the sale of this product involved: (a) lack of adequate disclosure to customers about the product they were buying, and the resulting asymmetry of information between provider and customer; (b) inappropriate default settings, where it was left to the customer to opt out of buying the product when purchasing another financial product; (c) the existence of inappropriate commission structures, which focused the rewards for salespeople on selling PPI, rather than serving the customer well; and (d) accounting practices which allowed firms to book an upfront profit from selling single premium PPI policies.

The resolution of the problems in PPI has taken a long time. Which? first raised concerns about the mis-selling of PPI in 2002. An initial 'supercomplaint' by Citizens Advice was made in September 2005 to the Office of Fair Trading (OFT). The OFT followed up this complaint with a market study, launched in April 2006, which subsequently led to a market investigation reference, in February 2007, to the Competition Commission (CC). In 2009, the CC ruled it would be banning the sale of PPI alongside credit products, stipulating that lenders and credit card providers would have to wait at least seven days before approaching a customer about the sale of PPI. Following an unsuccessful appeal by the banking industry, the CC provisionally confirmed this ruling in May 2010, and published its final remedies in July 2010, almost five years after the issue was first raised by Citizens Advice.

In 2005, the FSA conducted a series of mystery shopping and supervision exercises and in September 2005 called on firms to take "urgent action" to ensure that their selling practices for PPI were compliant with regulatory requirements. However, firms did not respond to the FSA's regulatory action and continued to mis-sell PPI. The FSA responded by conducting further rounds of mystery shopping and eventually conducting enforcement action and levying fines. However, these fines were such a low proportion of the revenue gained by banks from selling PPI they failed to have the desired effect. Despite, widespread mis-selling, no senior management in financial services organisations had enforcement action taken against them. The only senior management individual to have enforcement action taken against them for mis-selling unsecured loan PPI was the chief executive of a furniture retailer (Land of Leather).[15] Eventually, at the start of 2009, the FSA eventually secured “agreement” from the industry to stop selling single premium PPI on personal loans. The problems for consumers have been compounded by the failure of firms to deal with complaints fairly. Consumers have faced unreasonable delays and the Financial Ombudsman is upholding over 90% of complaints received about some firms. This indicates that many firms are dismissing valid complaints and hoping that consumers do not go to the Ombudsman. The FSA is currently consulting on an approach to require firms to review previously rejected complaints. The FSA announced in September 2009 that several banking groups had agreed to undertake a voluntary review. However, almost a year later, Lloyds TSB disclosed that it had yet to start its review of past sales.[16] The British Bankers Association has now applied for a judicial review of the FSA’s rules regarding the handling of PPI complaints.[17] This will lead to further delays for consumers.

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[15] http://www.fsa.gov.uk/pages/Library/Communication/PR/2008/039.shtml

[16] http://www.lloydsbankinggroup.com/media/pdfs/investors/2010/2010_LBG_Interim_Results.pdf, page 122

[17] http://www.bba.org.uk/media/article/bba-statement-on-ppi

Annex 3

Future of Banking Commission conclusions on Consumer Protection Regulation

The regulator responsible for consumer protection regulation should have both: (a) an explicit mandate to promote effective competition in markets in the financial sector; and (b) the necessary powers to regulate the sector to achieve this, including the ability to apply specific licence conditions to banks and exercise competition and consumer protection legislation. These powers will be concurrent with the competition powers of the OFT, and will enable the regulator to both enforce competition law and make market investigation references to the Competition Commission.

The aim of consumer protection regulation is to promote the conditions under which effective competition can flourish as far as possible, and where not, the regulator will be able to take direct action. In order best to promote the interests of the consumer, the regulator will encourage financial firms to compete:

1 On the merit of the quality and price of their products and services; and
2 To gain a competitive advantage by investment in innovation, technology, operational efficiency, superior products, superior service, due diligence, human capital, and offering better information to customers.

The regulator would step in whenever there is a sign of market failure. Market failures include: (a) poor quality information being disclosed to consumers when they are deciding whether to purchase products; (b) information asymmetry between the provider and the consumer; or (c) providers taking advantage of typical consumer behaviour such as the tendency evident in retail customers to select the default option offered, and reluctance to switch products because of inertia. Any sign of market failure indicates that competition is probably not effective, and the regulator should then take action to counteract the failure.

We are in favour of exploring further a number of specific measures that could be taken by a regulator with a dedicated remit for consumer protection:

1 **Ensure customers can easily transfer products and accounts.** This will significantly reduce barriers to entry for new market entrants, and may help tackle consumer inertia. The regulator could consider the introduction of a portable bank account number for personal accounts.

2 **Ensure customers with overdrafts are not overcharged.** This will ensure customers are treated fairly and reduce barriers for new market entrants.

3 **Set 'default' settings on services, products and accounts in the customer's best interest**. As Cass Sunstein and Richard Thaler point out persuasively in Nudge, customers tend to elect the default setting that they are offered, rather than make a decision about what they actually want. The consumer protection regulator would have the power to set default settings on services, products or accounts in the customer's best interest.

4 **Allow customers to choose to 'opt-in' to unauthorised overdrafts**. Customers who do not opt in may have some payments refused. Customers would therefore be made aware of the potential cost and inconvenience of these refusals resulting from not having an overdraft facility.

5 **Ensure banks do not take advantage of existing customers**. In the retail savings market, for example, consumer inertia often leads to a reluctance to switch accounts and providers. Currently, some providers take advantage of this inertia, by only offering their best deals to new customers, and denying existing customers access to newer versions of their existing products, which may have more favourable terms.

6 **Act to prevent obscure charges or unfair, asymmetrical contract terms where these are present in financial products and services.**

7 **Ensure full and transparent disclosure on all products**. For example, any fund, such as a with-profits fund, should have full annual reports showing how the funds have performed, and how much money has been spent on commissions and management fees. Generally, it should be assumed that information should be placed in the public domain unless there are strong reasons for it not to be disclosed.

8 **Consider introducing standard products for some basic services which all retail providers have to provide, and a common form in plain English to explain the key terms so that customers can easily compare products provided by different providers on the same basis**. Additional comparative information can also be supplied on customers' use of banking products–for example, through provision of an annual summary of charges, interest forgone and average balances in standardised format.

9 **Empower customers to seek compensation via a collective redress process.** The regulator should allow simple and effective collective redress to empower retail and SME customers who have suffered widespread failures of financial products or sales processes to seek compensation when serious and systemic harm has arisen. This process would allow representative bodies to act on behalf of many customers adversely affected by the same or similar issues, with examples being financial products or services which are (a) mis-sold, (b) sold under misleading pretences or

(c) subject to unfair terms. The Commission advocates that the process should be on an ‘opt-out’ basis, which would allow representative bodies to take action on behalf of all consumers affected. Previous cases such as Payment Protection Insurance and mortgage endowment mis-selling would have qualified for collective actions.

10 **Promote bank retail depositors to rank ahead of all other creditors, including bondholders.** This will facilitate governments allowing institutions to fail, reducing the risk to taxpayers and forcing management to face the full consequences of their risk-taking.

11 **Ensure consumer deposit accounts clearly highlight whether or not they are covered by the Financial Services Compensation Scheme (FSCS).** This will prevent market entrants like Icesave marketing less securely protected accounts to customers who are not fully aware of the extent of their rights. It is intended, however, that the reform of the liquidation preference, mentioned above, will reduce the likelihood that the insurance provided by the FSCS is called upon.

12 **Prohibit those commission structures which incentivise mis-selling.**

13 **Firewall conflicts of interest, and if the conflicts are intractable, force structural change to address the problem.** Particular attention would be paid to conflicts of interest between the financial institution and its customers.

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15 October 2010

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

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

White & Case LLP is pleased to be given the opportunity to respond to aspects of the consultation on the new approach to financial regulation in the UK.

We wish to register our view on the following consultation question:

Box 5.B

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 view is that it would not be helpful for the UKLA to be merged with the FRC as described in the consultation paper. The primary reason for this is that it does not seem to us to make sense for the UK's representative on the European Securities and Markets Authority to have a role advising on the application in the UK of EU rules which it has had no direct role in creating. If the proposal were to be implemented and the UKLA sat under the FRC not the CPMA, we understand that the UK would be the only member state whose representative on ESMA did not speak directly for the market participants it seeks to represent. In our view, simply requiring that the new body and the CPMA "cooperate closely" would not be enough to allow the new body to effectively represent the UK market participants' interests on ESMA.

As the consultation flags at paragraph 5.24, there are so many more aspects to the UKLA's remit than simply dealing with the corporate governance and company monitoring issues of UK incorporated equity issuers. We understand that only 6% of issuers listed on the London

Stock Exchange are UK companies with premium equity listings. The universe of issuers under the UKLA's remit is wider not only geographically than the UK but also in terms of the products issued (covering bonds, asset backed securities, warrants, etc.) so to move the UKLA wholesale to the FRC is not a logical step to take when looking at the effective functioning of the UK markets as a whole.

By housing the UKLA under the FRC, the UK's ability to take enforcement action for listing rule breaches and market abuse would, in our view, be impaired. It would seem to us to be far preferable for the CPMA to take a joined up approach to enforcement action across all areas of the UK markets (rather than devolve responsibility for listing rule breaches and market abuse to the FRC) so there is consistency of approach and no danger of any activity falling between two stools and going unchecked.

If you have any questions relating to this response, Philip Broke or Jennifer Charlesworth are happy to discuss it at your convenience

Yours faithfully,

White & Case LLP

Response to HMT

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

1. The Wholesale Market Brokers' Association (WMBA) and the London Energy Brokers' Association (LEBA) are the European Industry Associations for the wholesale intermediation of Over-the-Counter (OTC) markets in financial, energy, commodity and emissions markets and their traded derivatives. Our members are limited activity firms that act solely as intermediaries in the said wholesale financial markets. As Interdealer brokers (IDBs), our members' principal client base is made up of global banks and primary dealers. The replies below to the questions in the paper should be seen in the context of member firms acting exclusively as intermediaries, and not as own account traders. (Please see www.wmba.org.uk and www.leba.org.uk for information about the associations, its members and products.) For this reason some of the questions in the CP are not entirely relevant to member firms' activities even though they are to most of their clients. Further, some answers take into account industry views and experience.

2. WMBA/LEBA notes and supports the analysis of the recent financial crisis (1.2) and the identification of weaknesses in the 'tripartite' system (1.4). It believes that it is right to identify and carefully define the roles of Macro-prudential regulation for maintaining financial stability, and the (Micro) Prudential regulation of individual firms (1.9 – 1.18). WMBA/LEBA feels that it is essential that this differentiation should be reflected in the way in which the CPMA works in practice, and how it engages with ESMA (5.2).

3. Whilst WMBA/LEBA favours the FPC having '...a single clear, unconstrained objective....' in principle (Questions 1-3), it notes the papers comments on the failures of the tripartite system and would stress the importance of a transparent MOU to define the operational interaction between the FPC, PRA and CPMA. This may mean in practice that secondary factors should be taken into consideration to avoid the 'underlap' identified by Lord Turner and Paul Tucker, but it is not clear why these need to be formulated in legislation. To do so might mitigate against the operational interaction required to avoid the mistakes previously made within the tripartite system.

4. The Association notes the potential macro-prudential tools (box 2.C) available to the FPC, but would like the paper to be equally specific on what micro-prudential tools would be considered. All of the macro-prudential tools considered would need to be applied to individual firms on a selective basis depending on the nature of the firm and the risks identified. It should be made clear what responsibilities the FPC assume for such an application. (See 3. Above).

Response to HMT

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

5. WMBA/LEBA particularly endorses the suggestion that the PRA should '....focus more on understanding institutions business models and strategies....' and believes that the PRA should have regard to the primary objectives of the CPMA and FPC (question 4). The FSMA principles for good regulation should be retained for the PRA, and the Association feels strongly that the PRA should have regard to the stimulation of competitiveness and innovation inherent in the UK financial system.

6. The Associations support the model proposed in 3.16 but would underline the necessity of the PRA and CPMA working closely together (question 5). It would stress the need for the model to take compliance costs for firms into account and to minimise bureaucracy.

7. The approach to the transfer of regulatory functions and rule making powers (3.17-3.23, questions 6-8) are noted and understood. WMBA/LEBA believes that any safeguards required are unlikely to be greater than those currently outlined in the FSMA, but would urge the PRA and CPMA to confirm adherence to an approach based on principle and risk based supervision.

8. WMBA/LEBA notes that the CPMA is a 'working title' and would point out that the practicalities of how the FPC, PRA and CPMA work together are of overarching importance. Within this constraint, it agrees that the CPMA should have regard to the stability of firms and the financial system as a whole by reference to the primary objectives of the FPC and PRA (question 10). The Association is concerned that not of enough distinction is made between retail and wholesale markets and suggests that COB rules (e.g. relating to TCF and Market Abuse) are applied proportionately. It also believes that the CPMA should have regard to any issues that relate to the competitiveness and innovative capacity of the UK financial services sector.

9. The accountability mechanisms for the CPMA are noted and considered appropriate as far as they are laid out in the paper (4.36 – 4.39). WMBA/LEBA urges that membership of the three proposed panels, particularly the practitioners panel, takes full account of the wholesale and international nature of the businesses regulated (questions 11-12). The proposed funding arrangements should also take full account of nature of the firms and the weight of business and supervisory resources applied to their regulation (question 13).

10. WMBA/LEBA welcomes the explicit requirement 'related to the promotion of market efficiency and integrity', and the 'recognition of the differences between retail

financial services conduct and wholesale financial markets conduct' laid out in 5.9 – 5.10. It notes that its members industry sector (Inter Dealer Brokers, please see Introduction) is not specifically mentioned in the participants in section in 5.8, but assumes that their activities are included in that definition as participants in 'OTC financial markets in which off-exchange dealings take place between bilaterally between financial institutions and other large wholesale market participants'. It urges the markets division of the CPMA to ensure that it is responsible for all firms active in wholesale traded and financial markets, and that they are regulated and supervised within the framework of a consistent approach to principles and risk based supervision, in order to avoid a fragmented approach to wholesale market regulation (questions 15-16). WMBA/LEBA further suggest a review of the application of Pillar 2 of Basel II and III (through the CRD) to Inter Dealer Brokers, and the use made of the Supervisory Review Evaluation Process (SREP) and ARROW risk assessments.

11. WMBA/LEBA notes and supports the plans for crisis management and the transition process laid out in box 6.A. It believes that major crises are likely to be international in nature, especially for the nature of its members business, and notes the comments made in 6.25 – 6.30. It hopes that the roles and responsibilities of international bodies, particularly within the EU, demonstrate clear lines of authority and distinguishes between Macro and Micro-prudential actions (questions 19 – 21).

If you would like to discuss this submission further please contact:

David Clark (Chairman)

Alex McDonald (CEO)

Wholesale Markets Brokers' Association
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We are a small firm of Managing Agents, managing Leasehold blocks of flats in Sussex. We were caught up with regulation purely because we paid insurance premiums on the blocks that we manage. We earn NO commission from this work yet we are required to pay fees to the FSA in excess of £1000 per annum and have the hassle of completing the lengthy returns to the FSA twice a year.

Does a firm such as ours really need to be regulated!!

Regards

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A New Approach to Financial Regulation:
judgement, focus and stability
Treasury Consultation
response by
Stephen Wynn

Executive Summary

1. The financial crisis was caused by the takeover of the regulators by the industry they regulate.

2. This consultation wants the industry to remain in control.

3. The regulation of banks should be separated from the regulation of the rest of the industry.

4. The emphasis on "consumers" and "consumer protection" is excessive. There should instead be an emphasis on protecting savings.

5. Financial regulators should be financed by a tax on savings, rather than by an industry fee.

6. Prudential supervision should not be separated from conduct of business regulation in separate organisations (PRA and CPMA).

7. The regulators should not have "statutory objectives", only "statutory duties".
8. These objectives or duties should not include the

> **promotion of confidence in "the financial system" or "financial services and markets".**

1. First impressions

1.1 "Those old ones are flawed."

The consultation is saying: "Those old ones are flawed."

> **.. the FSA's approach to micro-prudential regulation was flawed.**

But these "new" ones are "strong", "focused", "dedicated" etc. This happens repeatedly in this area. A search on "new regulatory" on the website of the FSA produces a list of "approach", "architecture", "challenges", "environment", "framework" , "initiatives", "policy/ies", "reforms", "regime", "structure" and "system", such as:

> **Our new regulatory approach will be proactive and preventative, aiming to head off problems in advance.**
>
> **Our new regulatory reforms such as introducing realistic reporting and treating customers fairly will introduce transparency and will, I believe, provide a basis for restored consumer confidence.**

All these new regulatory "approaches", "architectures"

etc, promise "fair": "benefits", "deals", "outcomes", "treatment" etc for "consumers" and/or "customers". A search on "change" produces an enormous list. There are calls for "cultural change" within the industry and "radical change" within the regulators. Lord Turner said in a speech recently:

> We need radical change. Regulators must design radically changed regulations and supervisory approaches, but we also need to challenge our entire past philosophy of regulation.

This is the way the industry operates. "Those old products are flawed. But these new ones are low-cost, transparent etc." On close inspection they turn out not to be "low-cost" or "transparent".

1.2 Exaggeration

The consultation document is very emphatic. "Will be" is mentioned 138 times:

> The new .. CPMA .. will be a strong consumer champion .. The FPC will be a transparent and accountable institution, ..

"ensure" 77 times:

> The creation of a regulator with specific responsibility for consumer protection will ensure that the interests of consumers are not forgotten about or subordinated.

This depends on who is in charge. The CPMA "and markets" seems to be intended to get industry people onto the board of the CPMA, so the industry is in charge. The CPMA does not have "specific responsibility for consumer protection", because it is also responsible for markets and has "a primary statutory responsibility to promote confidence in financial services and markets".

"Consumer protection" is a vague expression. What is this protection *from*? A search on "consumer protection from" returned nothing. Google most frequently returns "unfair trading". The Future of Banking Commission says:

> **To date, the focus of consumer protection in UK financial services, and elsewhere around the world, has been to control the process by which products are sold.**

So "consumer protection" focuses on the sales process. But for example, the BBC Panorama programme *Who took my pension* has a focus on protecting savings rather than consumers, since it discusses annual charges rather than the sales process.

"Consumer protection" is only a CPMA "objective", which is another vague expression. They might say: "Sorry we did not achieve our objectives." It is not even an objective on its own, but part of the "primary

objective" (also referred to as the "primary statutory responsibility"):

> The Government will legislate to provide the CPMA with a primary objective of ensuring confidence in financial services and markets, with particular focus on protecting consumers and ensuring market integrity.

The consultation has a considerable number of superlatives about the new approach, counting words: new 154, important 36, effective 32, clear/ly 28, transparent 26, strong 21, focused 11, credible 12, dedicated 6, consistent 5, stable 3, constructive 1, fair 1, prudent 1, specialised 1.

They sometimes go together: transparent and accountable, fair and transparent, clear and transparent, focused and clear, focused and specialised, strong and credible, credible and effective, consistently and effectively, consistent and complementary, stable and prudent, stable and credible, constructive and independent.

1.3 Financial stability

The consultation starts: "The UK banking system", and is mostly about banks:

> The objective is to reform the regulatory system for financial services to avoid a repeat of the financial

> **crisis.**

This was a banking crisis. The regulation of banks should be separated from the regulation of insurance companies and fund management companies. I recommended this in a submission to the Treasury Select Committee at the time the FSA was proposed in 1997. Other people also said that the FSA should be in two halves. They are intrinsically different. Banks are concerned with the flow of cash, insurance companies and fund management companies with savings and investments.

If you have symptoms of an illness which are untreated for year after year they are likely to develop into a crisis. The banking crisis is a manifestation of an underlying illness. That is regulators captive to the industry they regulate. This results in regulators not challenging the industry. The Lord Penrose report about Equitable Life said:

> **There was a general failure on the part of regulators and GAD to mount effective challenge of the management.**

The GAD was financed by a levy on the industry, like the FSA which did not challenge the takeover of ABN Amro by RBS, the Northern Rock business model and so on. Maintaining financial stability is concerned with the protection of the industry rather than consumers/ investors. The FSA has a new objective:

financial stability - contributing to the protection and enhancement of the UK financial system

"The UK financial system" seems to be a euphemism for firms. Similarly, the consultation paper is concerned with protecting the industry. Regulators should be concerned with protecting the public *from* the industry, rather than with protecting the industry. They should represent the interests of consumers/savers/investors.

1.4 The investor perspective is (almost) missing.

The consultation mentions "long-term product payoffs" (4.24). This is encouraging. I have been saying that the FSA should be concerned with the long-term performance of products for years. It should provide this as "consumer information". This would "help retail consumers achieve a fair deal" which is, or at least was, one of the FSA's "aims".

But otherwise the concerns of investors seem to be missing from the consultation. There is no mention of: unit trust, OEIC, investment trust, insurance fund, with-profits, saver, investor, fund manager, dividend, yield etc. Investors are concerned about their savings, deposits and investments. The CPMA is a "conduct regulator":

The CPMA will regulate:

the conduct of all firms – .. – in their dealings with

ordinary retail consumers,

What about the conduct of firms towards the savings which they hold? For example the recent BBC Panorama programme *Who took my pension?* and articles in the Telegraph:

£7billion a year skimmed off our savings
Charges and fees cutting 50 per cent from British savers' pension pots

The first rule of investing is: Don't be locked in. But pension saving is locked in to pension schemes. So providers can charge what they like. The consultation does not discuss this topic at all. It does not say whether fees/costs/charges are the responsibility of the PRA or of the CPMA. It does not even mention the words "pension" or "charge". Financial regulation should be concerned with the protection of finances, especially personal finances, especially savings.

2. Terminology

2.1 Terminology creep

Some expressions are counted in Table 1, comparing the Treasury consultation with the (original) Financial Services and Markets Act (2000) and the Financial Services Act (1986). "Duty/ies", "investor/s", "trust/ee" have strongly declined. "Objective/s", "consumer/s", "confidence" have strongly increased. This is a trend

towards increasing vagueness. It seems that "duty/ies" have turned into "objectives", "investor/s" into "consumer/s", "trust" into "confidence". "The protection of investors" has changed to "consumer protection".

Table 1

The number of times some words occur in the consultation and legislation

words	1986 Act	2000 Act	consultation
new	23	31	148
consumer/s	2	96	90
objective/s	0	20	77
role	0	12	73
important/key	0/0	0/0	36/31
consumer protection	1	0	32
confidence	0	11	9
duty/ies	48	91	6
the protection of consumers	0	4	1
investor/s	56	14	0
manager/s	87	157	0
the protection of investors	14	0	0
trust/ee	211	189	0

The objectives of the proposed new regulators divide into "primary" and "secondary". If they conflict, the

primary objective generally has priority over both secondary objectives, and also "secondary factors", "secondary considerations" and "'have regards'":

> In cases of direct conflict between primary and secondary objectives, the Government would generally expect the primary objective to override any secondary considerations

The PRA primary objective always has priority:

In the event that these objectives conflict, however, the PRA will be required to defer to its primary objective.

Looking under “primary” there are: "primary objectives", "primary statutory responsibility", "primary statutory objective", "primary legislation", "primary market activities". Under "secondary" there are: “secondary .. administrative measures”, “secondary factors”, "secondary considerations", "statutory secondary considerations", "secondary statutory objectives", "secondary legislation", "secondary market conduct".

Regulators should not be required to "promote confidence" in industry. People need to be sceptical about the claims of the industry rather than confident. There are many examples such as mortgage endowments.

> The Government will therefore create a dedicated consumer protection and markets authority

> (CPMA) with a primary statutory responsibility to promote confidence in financial services and markets. This objective will have two important components. First, the protection of consumers through a strong consumer division within the CPMA. And second, ..."

Rather than "two important components" why not say simply "two components"?

The terminology has changed from "maintaining confidence in the financial system" - the first objective of the FSA - to "promote confidence in financial services and markets". There is no mention of "confidence" in the 1986 Act, and no mention of "trust" in the consultation. A contributor to a discussion commented:

> Confidence is based on reason, so if confidence is misplaced that's the 'customer's own fault. Trust on the other hand is unquestioning, so if trust is misplaced that is not the 'customer's fault.

2.2 Prudential supervision

The consultation does not contain any formal definitions. What is "prudential supervision"?

> .. to ensure that the depositors are protected by the institution in question being financially sound.

So both the PRA and CPMA are concerned with "consumer protection", which is mentioned 32 times in the consultation but not apparently in relation to the PRA. The CPMA is a "conduct regulator". But the PRA is also interested in conduct, that is prudential conduct. So that not only are the PRA and CMA both concerned with protecting consumers, they are also both conduct regulators. The PRA-CPMA division seems at best misguided, because it splits this regulation.

Consumer Focus point out that regulators such as Ofcom and Ofgem have the statutory duty to protect consumers:

> **The ideal regulatory structure would:**
> **(a) put consumer interests first**
> **(b) be transparent, open and accountable**
> **(c) recognise its role in ensuring essential service provision and financial inclusion.**

The PRA protects deposits/policies by ensuring firms are financially sound. The CPMA should similarly be concerned with protecting savings/investments.

2.3 "Consumers"

The paper constantly refers to "consumers" and there are few other kinds of people: adviser/s 2, banker/s 2, broker/s 0, broker-dealer/s 2, consumer/s 90, depositor/s 1, director/s 9, investor/s 0, manager/s 0, saver/s 0,

shareholder/s 2, This habit of calling everyone "consumers" seems to have started with the 2000 Act which refers to "the protection of consumers". The 1986 Act refers to "the protection of investors".

The FSA is much concerned with "consumers". It even has a journal Consumer Research. The chairman of the FSA, Callum McCarthy, mentioned both "consumer responsibility" and "responsible consumer" in a speech:

> **What does caveat emptor mean in the retail market for financial services?**

Other adjectives are reversed with "consumer" on the website of the FSA, such as: "alert consumers" and "consumer alerts", "aware consumers" and "consumer awareness", "the conduct of consumers" and "consumer conduct":

> **A new supervisory approach to consumer conduct issues is long overdue.**

There is no reference to "investor/s" in the consultation. They seem to have become "consumers", that is "consumers of retail products". The FSA refers to "consumers of financial products and services", such as "consumers of investment products". "Providers" "provide products" which are "consumed" by "consumers". "Consumers" has a more industry orientation than "investors".

"The protection of consumers/investors" should be "the protection of savings/investments". But I could not find any reference to "the protection of investments" on the website of the FSA, and only one reference to "the protection of savings".

The constant repetition of "consumers" in the consultation paper is part of a strong industry orientation. It follows closely the Conservative Party white paper *From crisis to confidence* which is based on a report by Sir James Sassoon. George Osborne says in the Foreword:

> **Last autumn I commissioned Sir James Sassoon, formerly a Managing Director at the Treasury, to conduct a review of the tripartite structure.**

He was a former Vice Chairman of UBS Warburg, and industry champion, "the Treasury's Special Representative for Promotion of the City". This is listening to the wrong people.

3. Regulators (organisations)

3.1 "Regulated by the FSA"

The financial crisis is not the only reason for a new approach to financial regulation, including the Equitable Life saga, and the FOS. There was an article about the FOS in The Times: *Wronged consumers*

demand a better deal from the ombudsman **(2/10/10 page 63). Perhaps the most recent scandal at the time of writing is the Crown Currency Exchange. A comment following an article says:**

> **I now realise we are not covered by the FSA despite the firm being registered - makes a nonsense of them being able to use this on their documents if it actually means nothing.**

The Crown Currency Exchange was "registered" but not "authorised" by the FSA.

> **A "Registered" firm is NOT authorised under the Act.**

The consultation refers to "authorised firms" and "regulated firms". But "register" and "registered" are not mentioned.

> **The CPMA will also be responsible for the regulation (including prudential regulation) of all firms not regulated by the PRA, including most investment firms, ..**

"Regulated by the FSA" now becomes "regulated by the PRA" or "regulated by the CPMA", which is likely to increase public confusion.

A problem in this area seems to be regulated firms performing unregulated activities: "Unregulated

activities within regulated groups". Should this be permitted?

The concern with stability tends to increase the capture of the Government and regulators by the financial industry, such as the "Brown's bankers" phenomenon.

3.2 "In-built tension"

The reason for the division of the FSA into the PRA and CPMA is stated to be "in-built tension":

> **A The previous model of a single integrated financial services regulator meant there was an in-built tension between: the need to focus on the prudential health of regulated firms on the one hand; and the need to devote sufficient attention to the conduct of firms in retail markets and participants in wholesale markets.**

The consultation says the CPMA will have "no in-built tensions between different objectives". But there is an in-built tension between consumers and business. For example, it says the BIS Department is responsible for "consumer and business issues":

> **The Department for Business, Innovation and Skills (BIS) will have a strong interest in the new CPMA through its general responsibility for consumer and business issues. The Treasury and BIS will therefore jointly appoint a proportionate**

> number of non-executives to the board to ensure that appropriate expertise in these areas is available to the board.

But this should be "business and consumer issues" because it is headed by Business Secretary, Vince Cable, who says it is a "business department", which implies it is more concerned with "business issues" than "consumer issues":

> I see my role as the champion of business within the coalition.

It seems likely that the PRA will have a business orientation. Then if the CPMA has a consumer orientation, this will surely cause endless arguments.

3.3 Too many cooks

Separating prudential supervision from conduct of business, in the PRA and CPMA, introduces a too many cooks problem:

> .. will require a significant degree of cooperation and coordination by the authorities to ensure that they avoid duplicating efforts, or cutting across each other’s work.

Coordination between the PRA and the CPMA is summarised in: "Box 3.B: Coordination between the authorities", and with the FPC in the section:

> Links with the PRA and CPM,
>
> **.. there will need to be close cooperation between the FPC and the two regulators – the PRA and the CPMA - ..**

Savers are interested in their savings being protected, which conduct of business does not do. It permits the deduction of all sorts of expenses:

> **"Examples of expenses are:**
>
> **(a) registration fees;**
> **(b) safe custody fees**
> **(c) trustees' fees;**
> **(e) audit fees;**
> **(f) regulators fees and subscriptions;**
> **(g) costs of investment management but excluding dealing costs of the underlying portfolio, and costs associated with routine management and servicing of existing property investments;**
> **(h) bid/offer spread in the pricing of units**
> **(3) The spread in (h) should be on a basis that fairly represents the expected levy of such spread in a firm's experience of normal trading conditions.**
> **(4) The expenses should include allowance for any value added tax which is not recoverable." (COB 6.6.67)**

The consultation says:

> **Perhaps the most obvious failing of the UK system, however, is the fact that no single institution has the responsibility, authority or powers to monitor the system as a whole, identify potentially destabilising trends, and respond to them with concerted action**

Which is a too many cooks problem, or perhaps a regulatory gaps problem. That is problems falling between gaps. There is an example in the consultation:

> **a phenomenon whereby macro-prudential risk analysis and mitigation fell between the gaps in the UK regulatory system.**

Having firms regulated by more than one regulator "can lead to confusion":

> **Currently the responsibility for regulating consumer finance is divided between the FSA and the Office of Fair Trading (OFT). .. This division across two regulatory bodies can lead to confusion,**

The consultation says prudential and conduct of business regulation should be separated because:

> **Prudential and conduct of business regulation require different approaches and cultures, and combining them in the same organisation is difficult.**

This is not convincing.

3.4 Fees for regulation

The consultation proposes that the new system should be financed by fees on the industry. It is proposed that the CPMA is responsible for:

> the raising of levies to fund the activities of the PRA and CPMA and the collection of fees on behalf of the Financial Ombudsman Service (FOS), Financial Services Compensation Scheme (FSCS) and the Consumer Financial Education Body (CFEB).

These fees are passed on to savers. The regulator should be financed by a tax on savings because: "He who pays the piper calls the tune."

3.5 Fading away

The FSA's "aims" seem at first sight to have disappeared from its website. There are "Aims and objectives" on "About the FSA". But where are the "Aims"? Until recently the "aims" were separate from the "objectives". Clicking on "Aims" brought up a list of three aims. They have not been lost entirely:

> The aims of the FSA are to promote efficient, orderly and fair markets; to help retail consumers

achieve a fair deal and to improve our own business capability and effectiveness.

The FSA's "principles" are also fading away because:

a principles-based approach does not work with individuals who have no principles

Rather than lists of abstract "objectives", "aims", "principles","secondary considerations" and so on; the key question of a regulatory system is: Who's in charge? The consultation says that the CPMA will have "focused and clear statutory objectives". But its board will be appointed mainly by the Treasury, who have a track record appointing people from the industry.

4. Helping consumers

4.1 "Consumer champion"

The CPMA is described as a "consumer champion". But then so is the FSA. It has a "protection of consumers objective": "securing the appropriate degree of protection for consumers". It says on its website: "Watchdog gets into its stride as consumers champion". The Conservative Party white paper *From crisis to confidence* says that the proposed CPA will be more of a consumer champion than the FSA:

The CPA will take a much tougher approach to consumer protection and will be given a mandate

> **to act as a consumer champion. It will be a far more consumer-orientated, transparent and focused body than the FSA.**

This reads like the SIB's 1997 *Report to the Chancellor on the Reform of the Financial Regulatory System*. In 2001 the FSA had a public exchange of letters with the Consumers Association, which unfortunately have been censored. At least they are no longer available. From the consultation paper it seems unlikely that the CPMA will be any more a consumer champion than the FSA.

The PRA board (3.23) and CPMA board (4.32) will have a majority of non-executive members largely appointed by the Treasury. This does not seem "independent", moreover:

> **.. to complement the board of the CPMA, the Government will legislate to create an executive 2committee of the board, which will have responsibility for taking significant supervisory and regulatory decisions. The Government expects the CPMA's non-executive directors to participate in this executive committee where they do not have a conflict of interest.**

The FSA says on its website:

> **The FSA is governed by a Board appointed by the Treasury. .. The Treasury appoints the Directors of the Authority following the principles for public**

appointments issued by the Commissioner for Public Appointments ('Nolan Principles').

The Treasury has a long track record of appointing people from the industry to the board of the FSA. It should therefore not be responsible for appointing people to the boards of the CPMA and PRA. This presents the problem how these boards should be appointed. There is too much to say about this to be included with this response.

4.2 The same people

The consultation paper blames the problems of regulation on the "tripartite model" and regulatory "architecture", "framework", "structure", "system". For example:

the system .. failed:
to identify the problems that were building up in the financial system

One problem was Equitable Life. The FSA was told about it and failed to act:

The insurance directorate gave a clear signal of the danger of insolvency, and the need for urgent and major action. We must ask why the FSA did not act. It took action to strengthen reserves, but why did it not act commensurately with the scale of the

> **problem that had already been identified?** [x]

It also apparently ignored warnings from the Bank of England about the forthcoming credit crunch. The Conservative Party white paper has a heading:

> **The Bank's written warnings about imbalances were ignored**

The problem with the system of regulation is the people in the first instance, rather than the structure. But the people such as Hector Sants and other FSA staff are staying the same and there is going to be a new structure, dividing the FSA staff between the CPMA and PRA:

> **allocate FSA staff and responsibilities in anticipation of the formal creation of the CPMA and the PRA**

The people are discussed in the Conservative Party white paper *From crisis to confidence:*

> **There is no consumer representation on the existing FSA Board. Ten of the twelve members are currently, or have previously been employed in the financial services industries. This may have diminished the regulator's understanding of consumers and willingness to challenge the industry.**

There is no reference to "consumer representation" in the consultation paper. There is a reference to "institutional representation" and "external representation":

> **The FPC (like the MPC) will have strong, credible external representation.**

Regulators captive to the industry they regulate is of course also a problem in the US, as discussed by Harry Markolopos. This consultation seems to want this situation to continue. The people the Treasury appoints to the PRA and CPMA boards, are likely to be from the industry with "experience of banking, but also other financial sectors such as insurance and investment banking".

What kind of "experience"? People at a senior level will be appointed. This implies people from the industry regulating their friends, which is "revolving door politics". This is a global problem, which in my opinion is the origin of the credit crunch/financial crisis. It results in a failure to challenge the industry. "Experience" should mean experience as a customer and investor.

> **.. by putting in statute the requirement that each authority will have regard to the objectives of the other, the legal framework will ensure that the authorities will have each other's interests in mind**

> when making regulatory or supervisory decisions or considering new policy;

It will on the contrary not ensure this at all. The new regulators will have various statutory objectives. But how they actually behave depends on who they are, who is in charge. I agree with an article in the FT advisor *Osborne's panel to break-up FSA under fire from IFAs*, this is more of the same in the name of consumers.

4.3 "Capable and confident consumers"

The consultation discusses The Consumer Financial Education Body. The FSA says that people should not study products very deeply. It says (or said) on its website:

> Like buying a car or a washing machine, you don't have to get to grips with the detailed workings under the bonnet or inside the case,

It wants "capable and confident consumers" who are "alert", "aware", "beware", "educated", "informed", "responsible" and above all "shop around", which it compares with Christmas shopping:

> Shopping plays a big role in most peoples lives around this time of year, as millions of Britons hunt around for last minute Christmas bargains. Now you can get advice on how to shop around for the best deal in financial products as well, with the help

of the FSAs new Shop Around web pages.

As people become older there may be more a question of what they have forgotten, rather than what they know. A problem I have come across is elderly people who start investing in unit trusts on the advice of an adviser which they refer to as their "funds". But over the years some of these "funds" become insurance funds, and they do not know the difference.

Some people are not capable and confident investors and never will be. This is the reason for the Madoff scandal. Some people become capable and confident investors only when they retire and have time to study the stock market. People should be introduced to stocks and shares at school to have some familiarity, or they may have a lifetime of being scared of the stock market. Financial education should be more than just distributing the FSA's "advice on how to shop around".

5. Conclusion

The financial crisis and bank bailouts is only the most spectacular result of capture of the regulators by the industry they regulate. There are more subtle effects. It results in lack of reform and delays. For example, the problem of firms competing for outlets by paying commission to "advisers" which is the subject of the Retail Distribution Review goes back many years. It was discussed in the Gower Report which preceded the Financial Services Act (1986).

This consultation is written from the point of view of the financial industry. This can be seen in various ways: the constant reference to "consumers" and to "consumer responsibility", making promises, the appointment of people "with experience" to the FPC, PRA and CPMA boards meaning people from the industry, no mention of "product regulation". So that the regulators will continue to be controlled by the industry.

6. Consultation responses

> **Information provided in response to this consultation, including personal information, may be published or disclosed ..**

"Personal information" is vague. In my opinion responses should not be published anonymously.

The responses to Government consultations are usually not published. This results in much valuable information not being easily available. It is possible to obtain them by making a Freedom of Information request (which may be heavy going). But this does not facilitate "a frank and open debate":

> **The establishment of a new, focused body presents a key opportunity for a frank and open debate about achieving the appropriate balance between the regulation and supervision of firms, consumer responsibilities, consumer financial capability and**

> **the role of the state. These issues will be addressed as the CPMA is established**

There are other issues which need to be debated and addressed, such as: "Who took my pension?" The Treasury says:

> **This consultation is aimed at financial services firms, including banks, building societies, insurance firms, Independent Financial Advisors, exchanges, brokers and related trade associations, as well as consumer representatives.**

These are firms and representative organisations. Which "consumer representatives"? The Consumers Association (Which?) were uncritically enthusiastic about the FSA when it was set up, mortgage endowments, stakeholder pensions, and so on. What has happened to "power to the people"? If the government wants public support for its new approach the consultation should be aimed at the public. But we are being excluded. The responses from individuals may not be published:

> **Responses from individuals are not normally published in order to protect their privacy. (email from the Treasury acknowledging this response)**

Rather than requiring privacy, I like to be contacted with comments about my response.

This response is at:

www.comparativetables.com/orgre.htm

October 2010

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

Your reference

Our reference

Date 14 October 2010

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

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Dear Sirs

We welcome the opportunity to contribute to this consultation. As you may know, Zurich Financial Services Group is an insurance-based financial services provider with a global network of subsidiaries and offices in North America and Europe as well as in Asia-Pacific, Latin America and other markets. Founded in 1872, the Group is headquartered in Zurich, Switzerland. It employs approximately 60,000 people serving customers in more than 170 countries.

We welcome the set of measures that the Treasury has proposed to ensure that the Prudential Regulatory Authority and the Consumer Protection and Markets Authority work closely together. However, there are some issues that still need to be addressed:

- There are other regulators that need to be consulted to ensure effective regulation, including tax authorities, the European Union and competition authorities. When consulting on new rules, the PRA and CPMA should be required to publish an impact statement, setting out the effect the new rules will have on other regulatory jurisdictions, and how they will engage in a consultation process with stakeholders in partnership with other regulators.

- For incoming EEA branches that are regulated from a prudential perspective by supervisors outside the UK, care should be taken to ensure that the UK authorities do not duplicate the work of 'home' regulators. This can be achieved through a clear demarcation of responsibilities between the different regulatory bodies.

  For example, taking the FSA's current set of principles, Principle 4 clearly sits with the PRA or the equivalent EEA supervisor and Principle 6 should sit with the CPMA. It would appear to be fundamental that Principle 3 would be within the remit of the prudential regulator, however there could be an argument for the CPMA to have a relevant version of Principle 3.

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- There are some areas - such as the regulation of a firm's systems and controls and the Approved Persons regime - that apply to both the PRA and the CPMA. Where firms are regulated by both the PRA and the CPMA in the UK, the rules for and supervision of these areas should be organised in as holistic a way as possible, so to avoid duplicative or contradictory supervision. Where firms are subject to both regulation by UK regulators and other EEA regulators coordination should be achieved through colleges of supervisors, whose establishment and development we support wholeheartedly.

- There needs to be closer co-ordination between regulation and complaint resolution and the FSA restructure provides an opportunity to make progress on this front. The Government should implement the recommendations of the 2008 Lord Hunt review to improve the Issues with Wider Implications process.

We agree strongly with the suggestion in Paragraph 4.46 that there should not be cross subsidies between different sectors within the FSCS. This kind of cross subsidy does not exist in other markets, and is unfair to firms that do not pose systemic risks. The original intention of the FSCS was for it to be a single scheme, but with sectoral subdivisions, without any cross subsidies between the different sectors.

Yours sincerely

Matthew Connell
Government and Industry Affairs

Consultation questions
The Bank of England and Financial Policy Committee (FPC)

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

&

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

The FPC should have an objective requiring it to ensure strategic co-ordination between different regulators. For example, if the CPMA is considering an industry-wide review in order to compensate consumers for systemic misselling, there should be a forum where the CPMA and the prudential regulators can discuss the implications of such a review before firm proposals are made. Currently, the FSA Board provides such a forum for this kind of dialogue.

If the FPC is not considered an appropriate forum for such discussions, another forum should be created, as such intra-regulatory co-ordination on issues which do not have a macro-prudential effect, but which nevertheless have very large impacts on consumers and the industry should exist.

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

A requirement to co-ordinate on strategic regulatory issues should be expressed as an objective rather than a 'have regard', since it is a separate activity, not one that cuts across macro-prudential issues.

4. The Government welcomes respondents' views on:

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

The PRA should have regard to the primary objectives of the CPMA and FPC, although this should not be the only requirement for the two bodies to co-ordinate their actions.

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

We would prefer an integrated model, to avoid unnecessary duplication. This could be implemented through a "service entity" under PRA authority, and operating to both PRA and CPMA requirements.

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

Yes – regulators already have wide powers. Key to risk-based, judgement-focussed supervision is the appointment and development of high quality supervisors, and ensuring that they work within a framework which encourages co-ordination with other authorities.

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

&

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

Yes. The PRA should continue to be subject to statutory processes, including consultation with a practitioner panel, wider public consultation and the duty to carry out detailed cost-benefit analysis prior to the introduction of any new rules.

These processes embody standard regulatory principles that allow both industry and consumers to prepare adequately for regulatory change. They are processes that have increasingly been used by other rule making bodies – for example, the European Commission has consulted over several years on its Solvency II proposals – and are widely regarded as important aspects of a modern, professional regulatory regime.

Given that there will be an increased number of regulators in UK financial services, there should be a requirement on any rule-making body to publish a statement when new rules are proposed, setting out how the rules affect other organisations' jurisdictions, and setting out how regulators should consult on any overlaps.

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

The proposed governance structure appears reasonable.

Consumer protection and markets authority (CPMA)
10. The Government welcomes respondents' views on:

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

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

We agree that the CPMA should have regard to the stability of firms and the financial system as a whole, by reference to the primary objectives of the PRA and FPC. The Penrose Inquiry in Equitable Life underlined important overlaps between conduct of business and prudential regulation, and these overlaps should not be neglected in the new regulatory structure.

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

The accountability mechanisms are appropriate. As with the current FSA Board, there should be both consumer and industry representatives on the CPMA Board, to ensure that its decision making is rooted in a broad understanding of consumers' needs and the market.

Recent regulatory projects such as the Retail Distribution Review have shown that revisions of regulatory rules can have significant implications for the tax treatment of different products, for competition law and for European regulation.

It is important that when regulators develop new rules, they bring other regulatory institutions into the consultation process at an early stage, to ensure that the proposals achieve their original process. If this is not achieved, the rules could achieve unintended consequences, or even achieve the opposite of their original objectives.

When regulators develop new rules, their proposals should be accompanied by a statement setting out:

- How the regulations interact with other jurisdictions
- How the regulator will manage consultation with other regulators, to ensure that the impact of these overlaps are understood.

In this way, regulatory change will be more transparent, stakeholders will have a better opportunity to contribute to the consultation and harmful unintended consequences will be less likely to occur.

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

The Government should reconsider the recommendations of the 2008 Lord Hunt Review of the Ombudsman service, which suggested that the statutory panels could act as gatekeepers for issues with potential wider implications.

Currently, where a firm or a consumer group feels that a decision made by the Ombudsman has wider implications that should be examined by the regulator, the Ombudsman decides whether this process should go ahead. In this way, the Ombudsman both makes decisions and decides whether or not there should be a wider examination of these decisions.

We agree with the findings of the Lord Hunt Review (paragraph 53), that the decision to refer issues on to the regulators should not rest with the Ombudsman but with the Consumer and Practitioner Panels.

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

We agree that there should be a 'one stop shop' for fee and levy collection.

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

We agree strongly with the suggestion in Paragraph 4.46 that there should not be cross subsidies between different sectors within the FSCS. This kind of cross subsidy does not exist in other markets, and is unfair to firms that do not pose systemic risks. The original intention of the FSCS was for it to be a single scheme, but with sectoral subdivisions, without any cross subsidies between the different sectors.

Within the sectoral subdivisions we would support a risk-based approach, where groups of firms that create the most claims from the FSCS should pay higher levies.

Markets and infrastructure (Questions 15-18)

These regulators have limited direct relevance to Zurich's operations, so we have no comments

Crisis management

19. Do you have any overall comments on the arrangements for crisis management?
20. What further powers of heightened supervision should be made available to the PRA and the CPMA, and in particular would there be advantages to mandatory intervention, as described in paragraph 6.17?
21. What are your views about changes that may be required to enhance accountability within the SRR, as described in paragraphs 6.21 to 6.24?

We have no further comments.

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.

Some cost estimates appear too low. For example, in the transition to the FSA, altering wording on literature from 'Regulated by the PIA' to 'Regulated by the FSA' cost Zurich's life business £1 million. A similar exercise undertaken more recently for Zurich's general business, when its supervisory structure changed was £3.5m. This is because such wording does not only appear on leaflets, but also in the body of various customer communications, including letters to new and existing customers.

Transitions costs vary widely according to transition timetables – the tighter the timetables, the less time firms have to develop solutions for customer communications held on legacy platforms. As a result, flexibility over transition times can have a very beneficial impact on costs.