A new approach to financial regulations – Building a Stronger System
HM Treasury CM 8012

Box 2: D Consultation question

1. What are your views on the likely effectiveness and impact of these instruments as macro-prudential tools?
2. Are there any other potential macro-prudential tools which you believe the interim FPC and the Government should consider?

It is difficult to evaluate whether the tools set out in the consultation document, that the FPC can take to prevent a future systemic failure, are sufficiently robust to prevent such failure and whether this level of supervision will place too severe limitations on the everyday operations of financial institutions. From the point of credit unions, the systemic risks that may arise are relatively small, but the costs of funding an extra regulatory authority will be a major concern. Credit unions are already facing increasing costs on a number of items of expenditure, but are limited as to how much interest they can charge on loans to members. (However credit unions are not seeking an increase beyond the 2%.)

Box 2.F: Consultation question

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

The proposals in terms of the composition of the FPC, particularly the inclusion of non-bank members to bring in expertise and knowledge from other fields, seem to be appropriate. There is some concern about how transparent the FPC can be in balancing the information it gives to the public whilst guarding against giving information that may give rise to alarm. The consultation document seems to imply that information which is held back will eventually be released, but it is not clear how the aim to be transparent will work in practice.

Box 2.G: Consultation question

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

The sharing of information and co-ordination between the three authorities will be key to the effectiveness of the new system. It is helpful that the consultation document has set out its views on how this will operate in practice. This could be its strength, but may not be sufficient if roles become blurred over time, or has to deal with a large scale problem in the future, where there is serious banking problem and the FPC has to challenge the financial institutions in a crisis situation. From the credit unions' point of view it is helpful to have a clear proposal that the PRA will have sole responsibility for the regulations (CREDS).

We take the view that one authority should be responsible for authorisation and removal of permission. We are concerned that if this role is spread across two authorities, it would lead to duplication of work, the possibility of conflicting opinions, confusion for firms and extra costs.

Box 3.C: Consultation question

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

Whilst credit unions recognise the need for regulations, apart from about 11 very large credit unions, the majority are medium to small in size and can find some of the regulations overly bureaucratic and difficult to meet. The medium/small credit unions usually have few if any employed staff and are largely reliant on volunteers. Volunteers are sometimes dissuaded to serve as directors because of the weight of regulations. There is a continual need for the regulators to ensure that the regulations applied to this group of credit unions is proportionate to the benefits and that the words which appear frequently in the regulations – that they should be "appropriate to the size and complexity" of the firm are applied in practice.

Ace and UKCU are committed to encouraging and supporting the growth of our member credit unions to provide and enhanced service to their local communities. We have had some successes in helping credit unions reach sustainability, including merging where this is appropriate.

Box 3.D: Consultation question

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

No comment

Box 3.E: Consultation question

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

Our response to Question 5 is relevant to this question also. Whilst we recognise that credit unions are deposit takers and must take responsibility for all that this implies there is very little comparison between a bank and a small credit union with a few hundred members. There must be flexibility in how the rules are applied to credit unions to ensure that they are being managed responsibly, whilst recognising their inherent limitations.

Box 3.F: Consultation question

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

The explanation as to the separateness of the PRA seems to resolve the queries that were raised by others previously.

Box 3.G: Consultation question

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

The mechanisms in FSMA and the additional proposals set out in clauses 3.53 to 3.59 of this document would appear to ensure an appropriate level of accountability for the PRA.

Box 3.H: Consultation question

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

The FSA has operated a good scheme of consultation, although on some occasions it has felt that little account has been taken of the responses it has received. The standing consumer panels for large and small businesses have been very useful as a way of conveying the views of firms to the FSA and influencing decision making. The Bank and the FSA are holding a meeting in May to consult with all the credit unions about the change of regulator and this is greatly welcomed by the credit unions. Consultation is very important as firms subject to regulation and the wider public have much to contribute and it is good to know that consultation measures will continue on much the same basis, although we disagree with the decision not to have a standing consumer panel for the PRA and feel this would be a lost opportunity for the exchange of views.

Box 4.B: Consultation Question

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

We welcome the reforms and the decision to intervene at an earlier stage regarding products.

Box 4.D: Consultation questions

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

The FCA will have a number of functions – engaging more directly with customers and promoting confidence in the financial services; dealing with financial crime; investigating and reporting on regulatory failure; regulating wholesale markets; sharing duel regulation with the PRA for firms outside their remit. Whilst at one level these can be seen as part of the protection of service to the customers, these roles are very different and pressures and high demand in one area may be disadvantageous to another. For example, promoting business on the one hand may conflict with investigating financial crime on the other. The plans for governance and accountability seem appropriate on paper, but the diversity of tasks may make these tasks more difficult in practice.

Box 4.F: Consultation question

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

Some powers will be welcomed to provide additional protection for consumers where there is limited protection at present. However, these are strong powers which could lead to serious repercussions for service providers (and perhaps for customers). It is therefore important that there is consultation about the circumstances in which these new product intervention powers will be used.

Box 4.G: Consultation question

14. The Government would welcome specific comments on:

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

Whilst recognising the need to prevent detriment to customers, the possible threat of high fines greatly concerns credit unions as many are struggling to meet rising costs. A high fine that is appropriate for a

large bank is not appropriate to a small credit union. Fines need to be more flexible and to take into account the size of the firm and the level of services it provides.

In general, when judging the performance of credit unions, run largely by volunteers, it could be useful to look at some form of grading or grouping of credit unions that moves away from the current rather crude grading of Version 1 and Version 2, as this could help both regulatory staff and credit union directors to have a clearer understanding of how the regulations, policies etc should be applied to their situation.

Box 4.H: Consultation question

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

No comment

Box 4.I: Consultation question

16. The Government would welcome specific comments on:

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

No comment

Box 5.A: Consultation question

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

Whilst the consultation paper has provided clarification about how co-ordination will take place between the two authorities, it is difficult to comment at this point until the MoU is published and we can see how this will operate in practice.

Box 5.B: Consultation question

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

We agree with this action as the PRA is likely to have greater knowledge about a failing firm and may be able to assist the firm in improving its stability or in the case of credit unions, transferring its engagements to another credit union, or at least move to be being able to close down in an orderly way.

Box 5.C: Consultation questions

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

We prefer the alternative approach where one authority (either the FCA or the PRA) are charged with the processing of applications for those firms for which it will be the regulating authority. This will avoid

confusion for firms and ensure that a detailed knowledge of the firm making the application prior to registration will then be available to the authority responsible for on-going regulation.

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

With regard to variation of permissions we feel that each authority should be responsible for deciding on the varying of permissions of firms it regulates and also that the present OIVoP and WoP arrangements should continue.

For credit unions it is vital that regulatory staff with sound knowledge and experience continue to be involved in authorisation and variation decisions, due to the special nature of these firms.

Box 5.D: Consultation question

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

We feel duel decision making on approved persons is a recipe for delay in decision making, confusion for firms applying for approval and will lead to duplication and extra costs. We feel that one authority should be responsible for those it regulates, but can seek advice from the other where there are any concerns or grey areas.

Box 5.E: Consultation question

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

No comment

Box 5.F: Consultation question

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

We welcome the inclusion of a section on mutuals and that it proposes to modify the consultation requirements for both the PRA and FCA regarding cost analyses and their effect on such firms.

With regard to the registration of credit unions allocating registry powers to the prudential regulator seems sensible.

Box 5.G: Consultation question

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

At what point will consultation take place with firms about proposed new rules or changes to rules? It could be helpful to firms to be aware of any disagreement between the authorities when responding to proposals.

As for approved persons, the waiver of rules should be made by the regulating authority, with consultation between the two authorities' only taking place where there is an issue of concern, to avoid duplication and confusion.

Box 5.H: Consultation question

25. The Government would welcome specific comments on
    - proposals to support effective group supervision by the new authorities – including the new power of direction; and
    - proposals to introduce a new power of direction over unregulated parent entities in certain circumstances?

No comment

Box 5.I: Consultation questions

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

No comment

Box 5.J: Consultation question

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

No comment

Box 5.K: Consultation question

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

It is vital that the annual fee structure relating to credit unions continues to be based on the same formula as agreed with the banks and building societies and also continues to take into account their size and ability to pay. As stated previously in this response, the majority of credit unions are small/medium in size (and are struggling to survive I think this point should be removed as it could give rise to the perceived need for more intense regulation and subsequent fees as we would be deemed a higher risk!), faced with large increases in fees for insurance, technology, auditing, accommodation costs and the annual fees paid to the FSA including FOS and FSCS. (I suggest the remaining sentences are deleted - *The interest charges they can make on loans are restricted to 2%. The fees must be commensurate with their ability to pay.)*

Box 6.A: Consultation question

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

The proposed arrangements appear to satisfy previous concerns raised by others by setting out which authority will be responsible for particular rules/functions of the FSCS.

Box 6.B: Consultation questions

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

It seems appropriate for the FCA to take on the functions of the FSA. Transparency is important. The FOS newsletter, in particular, is very useful to practitioners in understanding how the FOS assesses and resolves complaints.

Box 6.C: Consultation question

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

An audit by the NAO will strengthen their accountability.

Box 7.C: Consultation question

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

No comment

CFA UK is a member society of

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

Dear sir/madam,

The CFA Society of the UK (CFA UK) welcomes the opportunity to comment on HM Treasury's updated consultation on a new approach to financial regulation.

The CFA Society of the UK represents more than 9,000 investment professionals working across the financial sector. For advocacy purposes, these members are represented by committees that consider proposals relating to professional standards and market practices. The committee's response is brief and addresses only some of the questions posed. However, we make a number of observations that we believe to be important and that we hope will be useful in directing HM Treasury's further work on regulation.

Summary

- The proposed measures are broadly sensible and an appropriate response to the recent financial crisis. The measures should help to reduce the risk of future systemic financial crises. That is to be welcomed.
- We also welcome the changed approach to the FCA so that there is a clearer intent to focus on the protection of market integrity (to the benefit of consumers).
- However, we are concerned that the new approach to financial regulation is too closely concentrated on 'fighting the last war' by focusing on systemic financial risk (the focal point for the FPC and PRA) and fails to make use of an opportunity to address regulatory weakness elsewhere.
- CFA UK recognises the benefits of a risked-based approach, however the FCA will need to ensure that the population of firms it determines to be prudentially significant must be both meaningful and effective. As we noted in our November response[1] to the original paper, across both the PRA and the FCA, there remains too little emphasis on supervision and enforcement. Regulatory measures will be ineffective without effective supervision and enforcement, just as they were prior to the financial crisis.

[1]CFA UK response to " A new approach to financial regulation: judgement, focus and stability," (Nov 2010) can be found at https://secure.cfauk.org/assets/2028/HM_Treasury_response_final_version.pdf

Insufficient focus on supervision and enforcement

There is much to welcome in HM Treasury's proposed approach. The introduction of a clear regulatory framework within which responsibility for the analysis and regulation of different elements of risk is assigned is a positive development. The governance structures and communication processes have been carefully considered and appear broadly appropriate. Accountability, too, has been improved.

However, we worry that too much confidence is being placed on the capacity for new regulation to effect change. Regulation counts for little in the absence of effective use of that regulatory framework through supervision and enforcement.

The frequency with which certain key words appear within HM Treasury's document give an indication of the scale of the problem. Regulation occurs 252 times; supervision 71 times. Regulators are mentioned 589 times; supervisors just 65 times. Enforcement is mentioned in only 38 instances.

As we wrote in November 'The experience of the financial crisis is likely to mean that regulators are aware of the need for more effective supervision for some time, but poor management will always occur, the sense that the system is working well will not take long to be re-established and, as the memory of the financial crisis fades, regulators' ability to draw sufficient funding will likely weaken.'

We accept that the regulatory framework required restructuring and that careful consideration needed to be given to the consequent governance and communication processes. However, there now needs to be a similar concentration of effort on the supervisory and enforcement practices that will support the new regulatory framework.

As is noted in 4.45 and 4.47, the FCA will have responsibility for the conduct of business regulation of all financial institutions – approximately 27,000 firms – and will be the prudential regulator for the 18,500 firms that will not fall within the scope of the PRA.

Box 4.E on p 69 makes it clear that the FCA will pursue proactive and intensive prudential supervision for a very small population of 'prudentially significant' firms. This approach will almost certainly fail and may cause the FCA to miss its operational objectives.

The approach will fail because the FCA will make a judgment at a single point in time as to which 100, say, of the 18,500 firms it should engage with; the others being allowed to report along established guidelines. However well FCA makes its selection, it will miss a number of potentially significant firms. Further, because it will not have good insight into the remaining 18,400 as they develop, the FCA will find it difficult to establish effective processes for dropping some firms from the list for supervision and adding the right new ones.

Supervisory conflicts

As stated above, we are concerned that HM Treasury's pays relatively little attention to supervision and enforcement and hope that this will be addressed in future.

Additionally, where proposals are made relating to supervision, we are concerned that HM Treasury's is over-optimistic about the likely efficiency of a coordinated approach.

Paragraph 5.67 on p.91 reads 'Where 'solo' prudential supervision of firms within the consolidation group is split across the PRA and the FCA, the regulators will coordinate their activities appropriately to carry out effective consolidated supervision, consulting each other as appropriate, as required by the general duty to coordinate.'

It is unlikely that this will work well in practice without the benefit of much greater thought and planning, though we accept that this might be done best outside of the regulatory framework.

We have additional concerns about the proposal (in 5.59) that both the PRA and the FCA should have the power to make rules applying to the same function within individual firm (as a consequence of dual regulation). HM Treasury's document breezily notes 'It is important, therefore, that the PRA and FCA consult each other prior to making such rules, to ensure a consistent and coordinated approach.'

The approach to approved persons also looks confused. Paragraph 5.48 reads 'For firms regulated by both the FCA and the PRA, the Government proposes that lead responsibility for controlled functions will be split between the PRA and the FCA in line with their objectives. Both authorities will have the power to specify new controlled functions and to approve or prohibit any individuals from carrying on these functions or regulated activities.' Despite the different areas of interest in terms of controlled functions, this approach provides the opportunity for confusion as to who is or is not an approved person, for which functions and under whose authority.

Financial Conduct Authority

We welcome the decision to name the new conduct regulator the Financial Conduct Authority, support the FCA's strategic objective and its operational objectives and applaud the determination to take a more interventionist approach where potential consumer detriment is identified.

HM Treasury's document lists a number of new tools and approaches relating to conduct of business regulation. CFA UK has mixed views on these.

Product banning

Though we understand the proposed aims in relation with this power, we are concerned that its use will, in practice, lead to considerable detriment for those individuals that have already bought a product. Liquidity in a banned product will be minimal. Unless a product can be banned at launch or very shortly thereafter, the FCA will have to be extremely careful in its decisions around banning.

Withdrawal of misleading promotions

We believe that the proposed powers will be extremely valuable and support the proposed approach.

Publication of enforcement actions

While we accept that the power to publish the fact that a warning notice has been issued might be broadly beneficial, we would encourage the FCA only to publish where there is extremely strong, almost uncontested evidence of an action requiring enforcement. Paragraph 4.89 indicates that the expectation will be that

publication will go ahead unless doing so might not be compatible with the FCA's objectives.

We believe that this would be unwise. First, it might discourage the FCA from issuing warning notices other than in cases where it is certain that enforcement will follow. That may have a negative impact on the FCA's achievement of its objectives. Secondly, there is a danger that consumers and other market participants will react immediately to publication of a warning notice. Even if a business is later subject to a notice of discontinuation, the effect on that business will be extremely damaging.

Oversight of client assets

We welcome the decision that protection of client assets will remain a regulatory priority and that the FCA will continue the intensive approach adopted by the FSA's specialist Client Asset Unit.

We trust that these comments are useful and would be pleased to meet the HM Treasury to explain or to develop them for further with the policy team.

Yours,

Natalie WinterFrost, CFA FIA
Chair Professional Standards & Market Practices Committee, CFA UK

Will Goodhart
Chief executive
CFA Society of the UK

Consultation Response

A New Approach to Financial Regulation: Building a Stronger System

Submission from the Chartered Insurance Institute

April 2011

Summary

- The CII welcomes certain additions to the proposals, including the attempts to acknowledge the uniqueness and importance of the insurance industry, as well as the inclusion of additional institutional mechanisms for ensuring effective coordination between the various regulatory bodies.
- We still however have two specific concerns:
    1. The new regulatory architecture may lead to **inefficient regulation** which channels too few resources into high risk areas because of too much supervision directed at low risk firms.
    2. The new regulatory architecture will have inadequate institutional mechanisms to ensure appropriate consideration of the very different risks posed by insurance relative to banking.
- In response to the first concern, we argue that in the new era of increased supervision and intervention, risk-based targeting should be designed to reflect more adequately the numerous degrees of risk posed by different financial services firms and activities – including **a stronger appreciation of the importance of a firm's culture.**
- As a result we believe that the regulator should take account of the relatively lower risks posed by those firms that adhere to high standards of professionalism, demonstrated by their measurable commitment to the highest levels of qualification, continuing professional development and ethical conduct. **Previous FSA research has shown that higher professional standards for financial planners results in better outcomes for consumers.**
- There are significant potential public interest benefits to be gained by the regulator recognising professionalism as a determinant of lower consumer risk. For example, it may incentivise firms to voluntarily adopt higher standards of behaviour which is likely to lead to a widespread improvement in consumer outcomes. **At present there is no regulatory incentive to do anything beyond mere compliance.**
- In response to the second concern, we argue that **the Financial Policy Committee (FPC) must contain at least one permanent member with insurance industry expertise**. Someone with an insurance background is not just necessary to provide views on industry related regulation, but also to give an informed view about emerging threats as a specialist in risk mitigation.
- Given the level of responsibility entrusted in the FPC, without this additional provision for insurance, there will always be the possibility that financial services regulation will become too banking focused.

About the Chartered Insurance Institute

The Chartered Insurance Institute is the world"s leading professional body for insurance and financial services with 97,000 members in more than 150 countries. We are committed to protecting the public interest by maintaining the highest standards of professional and technical competence as well as ethical conduct. We are a not-for-profit organisation governed by a Royal Charter, which sets out our public interest remit "to secure and justify the confidence of the public and employers" in the profession.[1]

Our membership includes over 29,000 members of the Personal Finance Society which is the UK"s largest grouping of financial advisers and related roles. We promote the highest standards of professionalism for the financial services community and we do this in part by setting exams and awarding qualifications to financial services practitioners at the Certificate, Diploma and Chartered levels. We also require our qualified members to sign up to a Code of Ethics and undertake annual continuing professional development, both of which we enforce through disciplinary measures.

Overall View

The latest Consultation Paper contains significant improvements on the original proposals set out in July 2010. In particular, the CII welcomes the additional passages to acknowledge the importance and uniqueness of the insurance industry and the inclusion of institutional mechanisms for ensuring effective coordination between the various regulatory bodies.

Despite these improvements however, we still have two specific concerns about the current proposals. First, as things currently stand, the new regulatory architecture may lead to inefficient regulation which channels too few resources into high risk areas because too much supervision is directed at low risk firms. Secondly, we remain concerned that the new regulatory architecture will have insufficient institutional mechanisms to ensure appropriate consideration of the very different risks posed by insurance relative to banking.

Incentivising Good Outcomes

In response to the first point, we reflect on the FSA"s current interpretation of risk-based targeting where firms face different levels of regulatory scrutiny depending on whether their business practices are rated as posing a „low", „medium" or „high" risk to consumer detriment. We then argue that, in the new era of increased supervision and intervention, risk-based targeting should be designed to reflect more adequately the different risks posed by the various types of financial services firms and activities. In particular, we argue that the regulator should take account of the relatively lower risk posed by those firms that adhere to high standards of professionalism, demonstrated by their measurable commitment to the highest levels of qualification, continuing professional development and ethical practise.

There are a number of potential public interest benefits to be gained by reducing the relative intensity of supervision for firms that demonstrate high standards of professionalism:

- It would enable the regulator to channel more resources towards regulating firms that pose the greatest risk to consumers.
- It would provide an incentive for other firms to voluntarily adopt higher standards of behaviour which, research suggests (see p.6) could lead to a significant improvement in outcomes for consumers.
- Research has also shown that firms with higher professional standards experience stronger consumer trust. Incentivising an increase in professionalism could therefore form an important part of the Government"s strategy to reduce the savings and protection gap by facilitating an improvement in the levels of engagement with financial products and services.

[1] Chartered Insurance Institute, Charter and Bye-Laws, Art 3(a).

Below, we provide two examples where firms have made measurable commitments to professionalism through industry led initiatives. The Aldermanbury Declaration and Chartered firms status could be used by the regulator as indicators of lower risk on the basis of a commitment to best practise.

Giving Appropriate Consideration to Insurance

In response to the second point on the regulation of insurance we argue that, as things currently stand, there are no specific provisions in the proposals for institutional mechanisms to ensure appropriate regulation of insurance. The only point of substance in the latest consultation paper is the notion that external members of the Financial Policy Committee should have industry expertise in areas like insurance and investment banking. This does not guarantee the presence of insurance expertise in the most powerful of the new regulatory bodies – it merely suggests that such an arrangement may occur on occasion. We therefore ask that it becomes a statutory requirement for a permanent member of the FPC to have a background in insurance. **The UK insurance market is the largest in Europe and third largest in the world - responsible for investments worth £1.6trn, equivalent to 24% of the UK's total net worth. It also employs around 275,000 people.** [2]

The FCA: Improving Risk-based Regulation

As the shadow regulatory structure emerges and the transition to the new architecture begins, conduct of business regulation is set to become much more intense, epitomised through the branding of the Financial Conduct Authority (FCA) as a 'consumer champion'. Building on the FSA"s January Discussion Paper on Product Intervention[3], the Treasury"s latest consultation sets out a broader remit for intervention on the premise that the FCA will have a, *'lower risk appetite for issues affecting a whole sector, sub-sector or type of product.'* New measures for intervention and disclosure include:

- 12-month product bans.
- Publishing more information on firms under investigation.
- Banning misleading financial adverts.

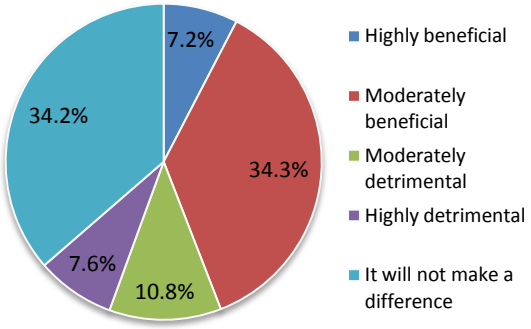
The FSA"s Business Plan also contains important clues about what we can expect from the FCA going forwards. It states that after the summer of 2011 conduct of business regulation will adopt a new „proactive supervisory approach" that will include a „wider spectrum of firms" including „non-relationship managed firms" and not just retail intermediaries. The Business Plan also states that regulation will be more risk-based „channelling resources to firms and particular issues where supervision is most needed".[4]

The message therefore appears to be that conduct of business regulation will intensify for all firms, but particularly for those firms posing the greatest risk to consumers. Whilst the CII welcomes attempts to reduce incidences of consumer detriment there must still be a clear relationship between the risks firms pose to consumers and the level of regulatory scrutiny they must face.

The view that increased intervention may be good for the consumer but that regulation must also be proportionate is reflected in a recent survey of our members. 42% of respondents thought that the „consumer champion" approach would be moderately or highly beneficial to the general public. This contrasts with 18% who believed that such an approach would be moderately or highly detrimental. At the same time, respondents felt that „overregulation and the associated costs to firms and consumers" would be the most important issue associated with the new structure. Please see Appendix A for the full results of this survey.

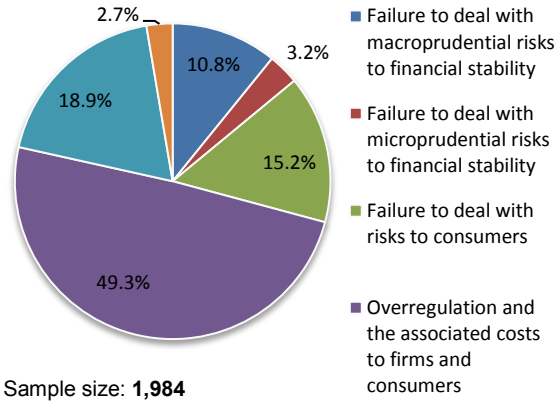
[2] ABI (Sep 2010), UK Insurance – Key Facts: http://www.abi.org.uk/Facts_and_Figures/53732.pdf
[3] FSA, (Feb 2011), ***Discussion Paper on Product Intervention***: http://www.fsa.gov.uk/pubs/discussion/dp11_01.pdf
[4] FSA, (Mar 2011), ***Business Plan 2011***: http://www.fsa.gov.uk/pages/Library/Communication/PR/2011/033.shtml

Figure 1. Members think the 'consumer champion' approach is more likely to be beneficial than detrimental to consumers



Sample size: **1,997**

Figure 2. Overregulation is the most important issue



Sample size: **1,984**

The FSA's current approach to risk-based targeting has been to assess the level of risk posed by firms in terms of the potential adverse impact of their activities on consumers, and the likelihood of detriment actually occurring. Firms are then grouped into three broad categories – low, medium and high risk. For medium and high impact firms the FSA coordinates its work through a relationship manager who carries out a regular risk assessment and determines a „risk mitigation program" in response to the risks identified. All firms, including those identified as low risk are subject to „baseline monitoring activities" which involve regular submissions of financial and other returns to the regulator.[5]

The above approach is not particularly subtle, and nor can it be when trying to regulate more than 27,000 separate firms. In future however, the regulator has committed itself to a more risk-based approach which would suggest improving on the current arrangement. In this regard, supervisory activities should be minimal where there is little risk of consumer detriment and increased where the risks are greatest. In meeting this aim a simple three tier system where „baseline" supervision is applied to all firms is inefficient as it reduces the amount of resources that can be channelled to the supervision of firms where the risks to consumers are greatest.

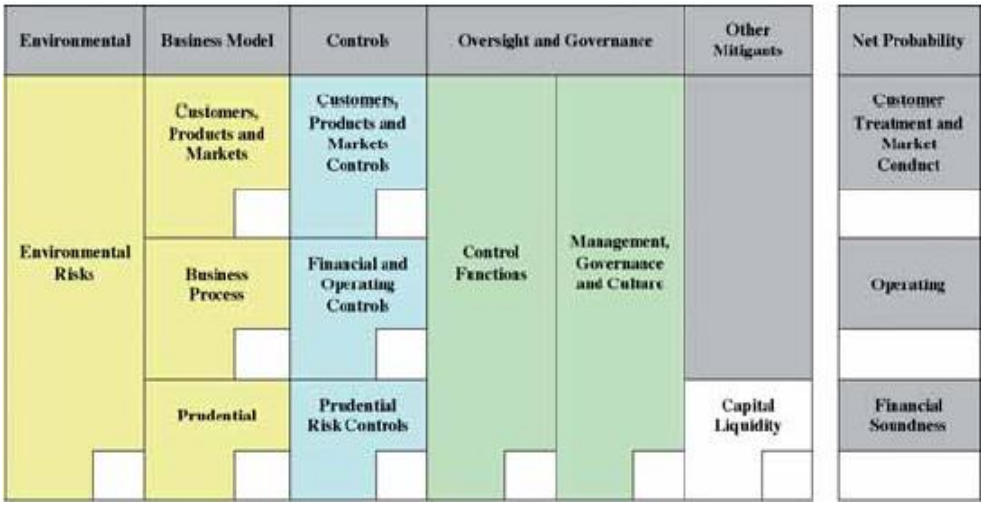
In creating a more efficient risk-based approach to regulation the new FCA should consider a broader, more flexible set of groupings than the „low", „medium" and „high" risk categories currently in play. This would better reflect the diversity of risks posed by the wide variety of financial services firms and activities in the market.

Improving Risk-based Targeting by Recognising Culture

To ensure that risk-based regulation is as efficient as possible it is also important that the indicators on which the regulator assesses firms are appropriate. Currently, in order to place firms within one of its three risk categories the FSA considers a number of different elements of which organisational culture is one of many. The chart below sets out the different factors that the FSA considers relevant in its assessment:

[5] For a breakdown of the FSA's risk assessment framework please see: FSA (Aug 2006), ***The FSA's Risk Assessment Framework***: www.**fsa**.gov.uk/pubs/policy/bnr_firm-**framework**.pdf

Figure 2: The FSA's Key Indicators of Risk – An ARROW II Visit



Source: FSA (Aug 2006), ***The FSA's Risk Assessment Framework***, p.41

Apart from the elements that make up the FSA's assessment of management, governance and culture, most of these indicators are concerned with structural issues. So for example, to measure risk posed by business processes the FSA looks at litigation and legal risk, IT systems and structure and ownership amongst others. Similarly with regards to control functions, the FSA reviews a firm's compliance, internal audit and enterprise-wide risk management. In fact culture is only made reference to in one of the 52 different elements that form a complete ARROW II assessment[6].

We argue that this relatively minimal consideration to culture is inadequate. We believe that the move towards a judgement-led approach to regulation should be accompanied by greater recognition of the importance of the cultural norms and values governing organisational behaviours and ultimately consumer outcomes. ARROW visits should therefore take into account practical steps made by firms to ensure best practise.

An organisation's culture and its structure are intrinsically entwined, both continually interacting with each other as an organisation evolves. In many cases then cultures may act to develop, reinforce or challenge the structural foundations of a firm. Appropriate regulation must therefore consider both to gain an accurate picture of a firm's riskiness. This argument is not new - in our response to the original consultation paper we referred to a speech by FSA Chief Executive Hector Sants on 4 October last year when he emphasised the importance of culture in determining outcomes:

'I would argue that some of the causes of the crisis were deeply rooted in behavioural or cultural issues that resulted in actions and decisions that, with the benefit of hindsight, were not the 'right' ones. Indeed, there are examples of actions and decisions by senior management that can be seen to be at the root cause of their firms' demise'[7].

If the Government and FSA accept that culture is an important determinant of firm behaviour, then the next step is to deliver measurable indicators that could form part of a new ARROW assessment. In this regard we believe adherence to high standards of professionalism could play an important part.

[6] Ibid, pp.54-55
[7] *Hector Sants (Oct 2010),* ***Can Culture be Regulated?****,* Speech to Mansion House Conference on Values and Trust: http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2010/1004_hs.shtml

Professionalism: Improving Consumer Outcomes and Strengthening Trust

So far we have argued that to create a more efficient risk-based approach to regulation the FCA should consider a broader, more flexible set of groupings than the „low", „medium" and „high" risk categories currently in use. We have further argued that the regulator should give a greater consideration to culture as part of an ARROW assessment of firm risk.

In the subsequent section we press the case for professionalism as an indicator of good culture. It follows that firms adhering to high standards of professionalism should have their level of risk downgraded in future and face proportionately less scrutiny as a result. There is clear justification for this approach: **research has shown that firms that have higher professional standards deliver better outcomes for consumers and benefit from greater public confidence.**

FSA Research into the Benefits of Professionalism

A commitment to **qualifications**, **continuing professional development** and a **code of ethics** are all important „pillars of professionalism"[8]. The FSA and the Treasury have acknowledged the importance of each of these elements for improving consumer outcomes as part of the Retail Distribution Review (RDR) which is aimed at raising the standards of retail investment advice. FSA research, referred to by the current Financial Secretary to the Treasury in November 2010[9], found that advice from practitioners meeting the highest professional standards (Chartered) was deemed suitable in **71%** of cases whereas advisers with the current mandatory qualification (certificate) delivered suitable advice in just **11%**.[10]

Professionalism and Consumer Outcomes in General Insurance

The FSA's research into the relationship between professional standards and consumer detriment is a good start but more research is needed in order to understand how the two are linked right across the spectrum of financial services. In response, we are currently investigating the relationship between higher professional standards in general insurance and consumer outcomes. To meet this aim, we are in the process of testing a number of hypotheses including that firms which demonstrate high standards of professionalism deliver: enhanced standards of risk and compliance management; improved standards of underwriting and claims handling; improved product design; and a greater focus on what is best for the customer.

Professionalism and Consumer Trust

Complementing our work on the relationship between professionalism and consumer outcomes is our research on consumer trust. In 2009, on behalf of the CII, YouGov surveyed over 2000 members of the public in an effort to understand consumer views about Chartered firms and individuals – those who abide by the highest standards of qualifications, CPD and ethics. This in depth survey, found that an important factor in determining whether or not people trusted a financial services firm or practitioner was whether they held the title „Chartered"[11]. The headline results were:

- Consumers expect greater professionalism from Chartered persons and organisations.
- Consumers have greater trust in advice from Chartered professionals than professionals that are not Chartered.
- Consumers believe that you can generally trust the advice you get from Chartered organisations.

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[8] PARN's research into the **„three pillars of professionalism'** can be found via their website: http://www.parnglobal.com/the-three-pillars-of-professional-standards_2.htm

[9] Mark Hoban, (29 Nov), **Commons debate about the regulation of Independent Financial Advisers** http://www.publications.parliament.uk/pa/cm201011/cmhansrd/cm101129/debtext/101129-0004.htm#1011302000275

[10] Consultation Paper 10/14: ***Delivering the RDR*** http://www.fsa.gov.uk/pages/Library/Policy/CP/2010/10_14.shtml

[11] CII (Polling by YouGov) (2009), ***Consumer Views of Chartered Status*:** http://www.cii.co.uk/downloaddata/Consumer_views_of_Chartered_status.pdf

- Consumers have more confidence in the quality of organisations that use the term Chartered than those that are not Chartered.

These results are noteworthy, particularly in light of the Government's current preoccupation with closing the savings and protection gap[12]. High levels of professionalism symbolised by the title Chartered, appears to act as an antidote to the current high levels of mistrust felt by the general public towards financial services. **Incentivising an increase in Chartered may therefore be one way to increase levels of engagement with financial products and services.**

Indicators of a Commitment to High Professional Standards – Carrots Rather than Sticks?

Industry-led initiatives like the Aldermanbury Declaration and Chartered status aim to raise the standards of professionalism in general insurance and financial planning **above and beyond** mandatory regulatory requirements. Firms that comply with these initiatives therefore commit themselves to the highest standards of professional behaviour, and may therefore pose less risk to consumers in the long term than equivalent firms that do not commit. Crucially, by easing the level of scrutiny for these firms, the regulator can incentivise others to adopt higher standards.

Through a proactive recognition of a firm's commitment to professionalism, the regulator can validate examples of best behaviour, and stimulate behavioural change for those who lag behind. This could result in a virtuous cycle with standards increasing across the board, to the benefit of the consumer. Carrots may work better than sticks.

The Indicators

1. Aldermanbury Declaration

In cooperation with leading figures in the general insurance market, the CII formed a task force in 2009 to raise professional standards in general insurance. The result was the Aldermanbury Declaration published in March 2010 calling on the sector to commit to a common framework of professional standards for its practitioners. The Declaration seeks to deliver the following benefits:

- Better outcomes for customers.
- Improved standards of risk management.
- A more confident, trusted profession.
- More talented people attracted to a career in insurance.
- Increasingly rewarding careers for those within insurance.
- Reinforcing the reputation of the London wholesale insurance market.

At the time of writing 200 firms, including all major insurance firms have signed up to this commitment. We believe these proposals are ambitious but realistic and have called on all firms signing up to implement the changes by December 2013.

Minister of State for Skills, John Hayes MP, has already acknowledged his support for the Aldermanbury Declaration, saying that it is as an "excellent example of the kind of arrangements that can be put in place, by industry, under the leadership of a professional body"[13].

2. Chartered Firms

Firms as well as individuals can attain Chartered title status. To become Chartered, firms must ensure staff members acquire and retain the necessary knowledge and skills to deliver the highest quality

[12] See for example the recent discussion paper from the Treasury on **Simple Financial Products**
[13] John Hayes MP (Nov 2010), ***Letter from Department of BIS to CII CEO Dr Alexander Scott***

advice. They must also work in an ethical manner that places clients' interests at the heart of the advice they give. Chartered status, granted by the Privy Council, gives insurers parity with other professional firms and distinguishes the Chartered title holders from competitors.

At the heart of Chartered firm status is a desire to deliver improved standards of knowledge and behaviour in general insurance and financial advice. This can be achieved by creating a framework that encourages and supports firms as they strive to raise standards of capability and ethical practice. A corporate Chartered title is therefore a commitment to an overall standard of excellence and professionalism.

There are currently over 350 firms with Chartered firm status.

Both the Aldermanbury Declaration and the Chartered firm initiative, reflect a growing movement towards higher professional standards within general insurance and financial planning. If, as we believe, increased professional standards decreases the risks of consumer detriment, then a firm that adheres to one or both of these initiatives is likely to deliver better consumer outcomes than would otherwise be the case.

Moreover, recognition by the regulator that firms complying with these initiatives pose less risk to consumers and therefore require less regulation would be consistent with the Coalition's pledge to: "end the culture of tick-box regulation and instead target inspections on high-risk organisations through co-regulation and improving professional standards". [14]

The Regulation of Insurance

A key concern which we raised in our original response to the July 2010 consultation paper was that a one size fits all regulator would result from the proposals. We stressed that:

'Insurance and banking are fundamentally different, highlighted by the relative success of insurance over the near collapse of banking during the financial crisis as well as the more long term nature of insurance and its different attitude to risk'.[15]

The latest consultation paper provides a few welcome indications that the new regulatory architecture will treat insurance differently to other financial services like banking. For example, as a result of the comparatively lower risk of an insurer facing a liquidity crisis or failing in a systemically important way, the consultation paper asserts that:

'…effective supervision of insurance firms for soundness and stability by the PRA may be achievable through a less intense supervisory approach than would need to be the case for a bank'.

Similarly, with regards to the governance of the FPC, the paper notes that:

'…it will be important to ensure external members are able to offer insights from direct experience as financial market practitioners - not only in banking, but also other sectors such as insurance and investment banking.'

The paper's acknowledgement of the specific risks posed by insurance, and the need for industry input into the FPC will go some way to alleviating concerns raised across the industry that insurance will not be properly regarded under the new regulatory structure. Nevertheless there is little specific detail about what less intense supervision might look like and there is no guarantee that someone with insurance expertise will have a long term influence on the powerful FPC.

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[14] The Coalition Agreement p.9: http://www.cabinetoffice.gov.uk/sites/default/files/resources/coalition_programme_for_government.pdf
[15] CII (Oct 2010), Consultation Response to: A New Approach to Financial Regulation: http://www.knowledge.cii.co.uk/system/files/CII%20Response%20to%20HMT%20condoc%20regulation%20Oct%202010%20(final%20version).pdf

On the first point, the Treasury and the FSA must take a view about what less supervision will mean in reality for firms, and communicate this as soon as possible to provide clarity to the industry. Perhaps the FSA will be able to explain this further when it publishes its policy paper in the summer about the philosophy of the FCA and the Prudential Regulatory Authority.

On the second point, we would argue that the FPC must contain members (either internal or external) with insurance expertise at all times. The FPC will be responsible for strategic oversight of the regulatory system, and for spotting and managing potentially systemic risks. Someone with an insurance background is not just necessary to give their views about industry related issues but also to give an informed view about emerging threats as a specialist in risk mitigation. The Treasury must therefore provide an additional provision for a permanent member on the FPC with insurance expertise. Given the level of responsibility entrusted in the FPC and the historical context of its inception, without this additional provision there will always be the possibility that financial services regulation will become too banking focused.

Box 1. Insurance versus Banking

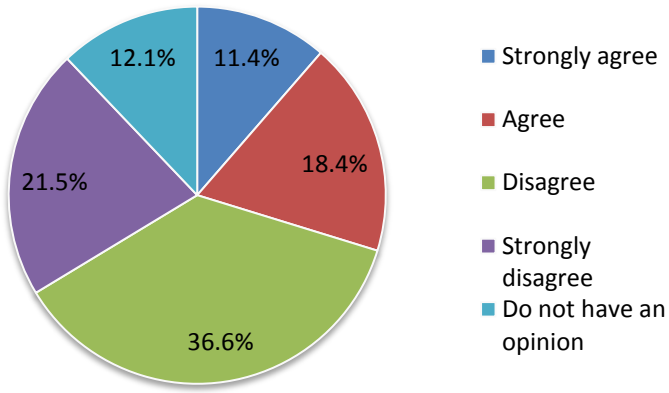
The primary purpose of insurance is to provide protection to policyholders against the risk of an adverse event occurring (such as property damage, premature death, liability claims etc) and to provide stable long term savings during the lifetime of an individual. Due to the long term nature of the business model, when an insurance firm gets into financial distress, the effects are likely to play out over a long time horizon giving regulators time to intervene to reduce potential losses. In addition, insurance companies receive premium payments in advance of claims payouts meaning that liquidity risk is rarely an issue.

Banks on the other hand engage in maturity transformation - borrowing short term (either through deposits or through wholesale funding markets) and investing this money in long term projects (such as property). In this business model problems can escalate quickly if depositors decide to withdraw their money, or wholesale funding markets dry up as occurred in 2008.

As a consequence of these very different business models, insurance is less likely to pose a systemic risk to financial stability than banking. Indeed there is, „..***little evidence of insurance either generating or amplifiying systemic risk, within the financial system itself or in the real economy'.*** (IAIS Position Paper on Key Financial Stability Issues, 4 June 2010)

The concern that insurance will not be regulated appropriately is echoed by our members. When asked whether they agreed with the statement "the specific needs of insurance have been taken into account" 58% either disagreed or strongly disagreed, in contrast to 29% who agreed or strongly agreed.

Figure 3. Members were asked whether they thought the specific needs of insurance had been taken into account by the proposed regulatory structure



Sample size: **1,230** (CII members only)

Conclusion

This paper has set out the CII's view on two specific concerns associated with the current regulatory review and our solutions to them:

1) The proposals, as they currently stand threaten to create an inefficient model of regulation where too few resources are channelled into supervising the riskiest firms because of too much regulation targeted at low risk firms. The regulator cannot be everywhere all of the time.

By way of a solution, we have proposed that the regulator considers a more tailored approach to risk assessment that reflects the variety of risks posed by different business practices and activities. As part of the new judgement based approach to regulation, this improved risk assessment should include recognition for good cultural norms and values held by firms. Consequently we propose that firms abiding by the highest standards of professionalism are likely to be less risky and should therefore face less supervisory scrutiny as a result.

2) Whilst the Government has acknowledged the importance of the insurance industry the proposals still risk leading to a one-size fits-all regulator.

In response we have asked that the Treasury and FSA provide more detail about how insurance firms will be regulated differently to banks – including what less intense supervision will mean in practise. We further propose that the FPC must contain a permanent member with insurance expertise. We firmly believe that someone with an insurance background is not just necessary to give their views about industry related issues but also to give an informed view about emerging threats as a specialist in risk mitigation.

The reforms to the regulatory architecture provide the opportunity for Government to get the regulation of financial services right. The financial crisis proved that a focus on structural details like liquidity and credit risk are not sufficient to prevent the meltdown of systemically important institutions. A change in direction is needed, and by recognising the importance of culture in determining consumer outcomes, the supervisors of tomorrow will truly demonstrate A New Approach to Financial Regulation.

Appendix A: Member Survey Results

Summary of findings

Members agree with the Government's view that the regulatory architecture needs to change and many also support the new 'consumer champion' approach to be adopted by the FCA.

However, members are yet to be convinced on a number of specific concerns about:

- The potential for overregulation and the associated costs.
- The regulation of the insurance industry.
- The regulation of small firms.
- The timeframe for transition to the new architecture.

Below, we present the results for each of the questions asked of our members. The survey was conducted in March 2011 and over a thousand people responded to each question.

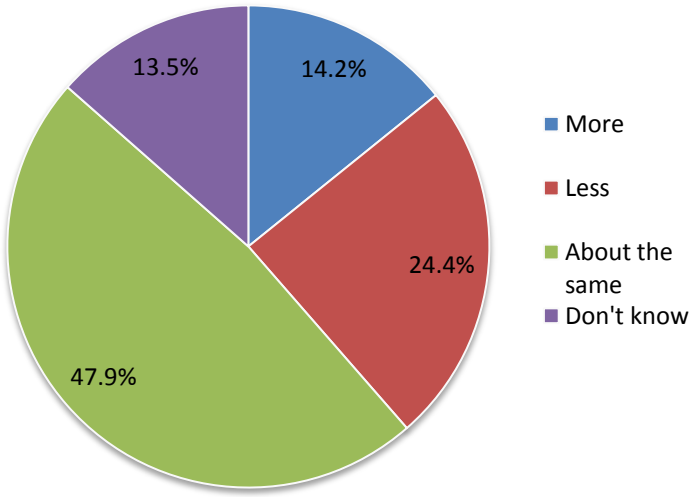
The questions

Q1: Are you more/less confident that UK regulation will be improved now that the Government has provided further details about its plans to reform the regulatory architecture?

The latest proposals have not increased overall confidence

- Nearly half of respondents feel 'about the same' regarding the prospects for UK regulation following the latest proposals.
- More respondents are 'less confident' than 'more confident' that UK regulation will be improved following the Government's latest announcements.

Overall CII Group results



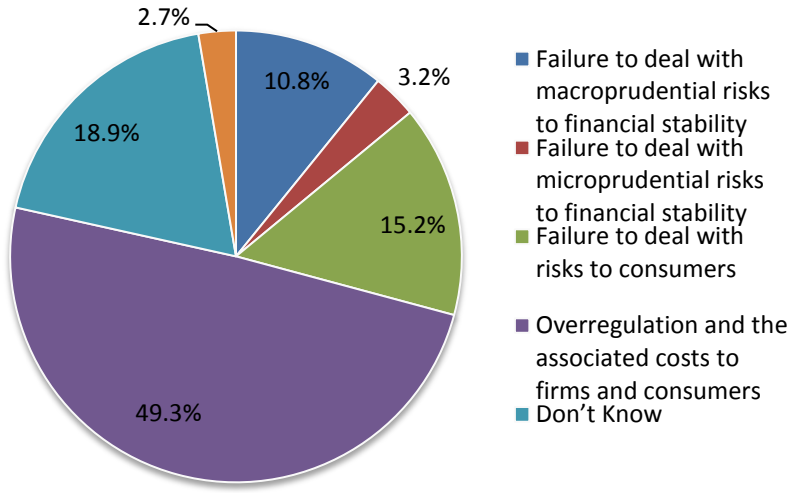
Sample size: **2,014**

Q2: Which of the following statements do you think best describes the most important issue associated with the new structure?

Overregulation and the costs to firms and consumers ranks highest

- Nearly half (49.3%) of respondents believe that overregulation and the associated costs to firms and consumers will be the most important issue associated with the new structure
- The second biggest concern is failure to deal with risks to consumers.

Overall CII Group Results



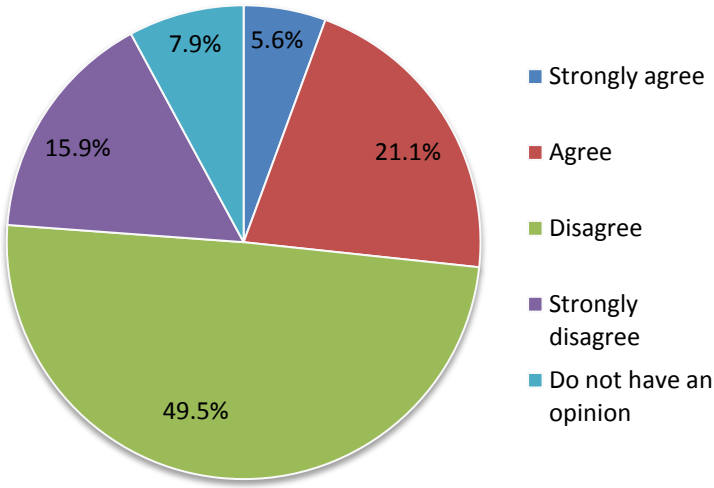
Sample size: **1,984**

Q3: There should be no changes to the regulatory structure. Please choose one of the following in response to this statement: strongly agree, agree, disagree, strongly disagree or do not have an opinion.

Respondents agree that reform to the regulatory architecture is necessary

- 65.4% of respondents disagree or strongly disagree with the statement that there should be no changes to the architecture.
- By contrast only 26.7% of respondents agree or strongly agree that there should be no changes.

CII members only



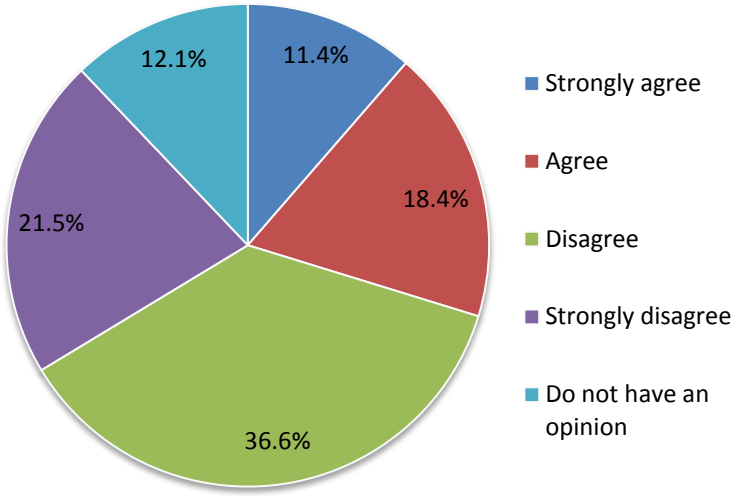
Sample size: **1,229**

Q4: The specific needs of insurance have been taken into account. Please choose one of the following in response to this statement: strongly agree, agree, disagree, strongly disagree or do not have an opinion.

Respondents do not think specific insurance needs have been taken into account

- 58% either disagree or strongly disagree that insurance has been taken into account.
- Only 29% agree or strongly agree with the statement.

CII members only



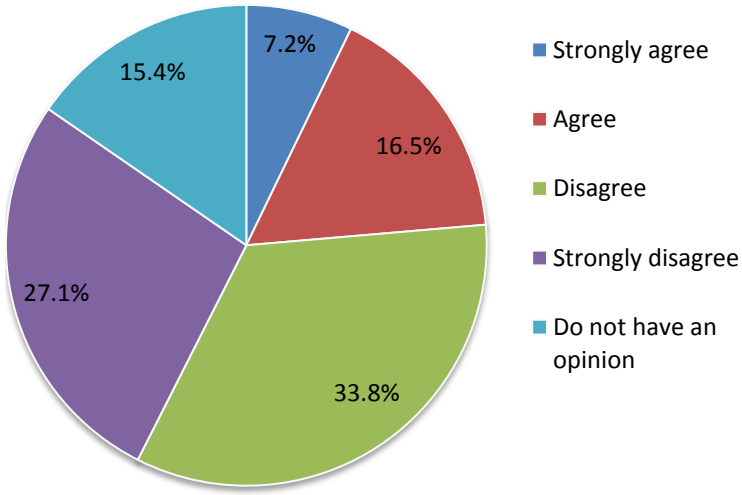
Sample size: **1,230**

Q5: The specific needs of small firms have been taken into account. Please choose one of the following in response to this statement: strongly agree, agree, disagree, strongly disagree or do not have an opinion.

Respondents do not think the specific needs of small business have been taken into account

- 60.9% of respondents disagree or strongly disagree with the statement.
- By contrast only 23.7% of respondents either agree or strongly agree.

CII members only



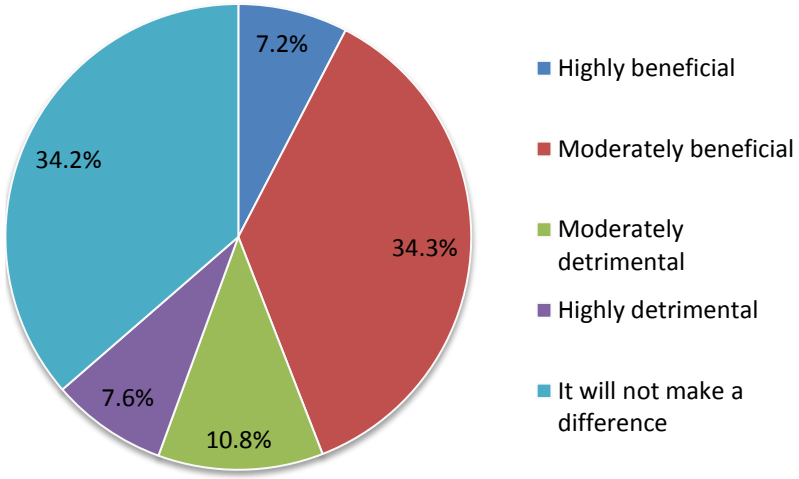
Sample size: **1,227**

Q6: Do you think it will be beneficial to the general public that the new conduct of business regulator is branded a 'consumer champion' with a more interventionist approach to regulation?

More respondents think the 'consumer champion' approach is likely to be beneficial than detrimental to consumers

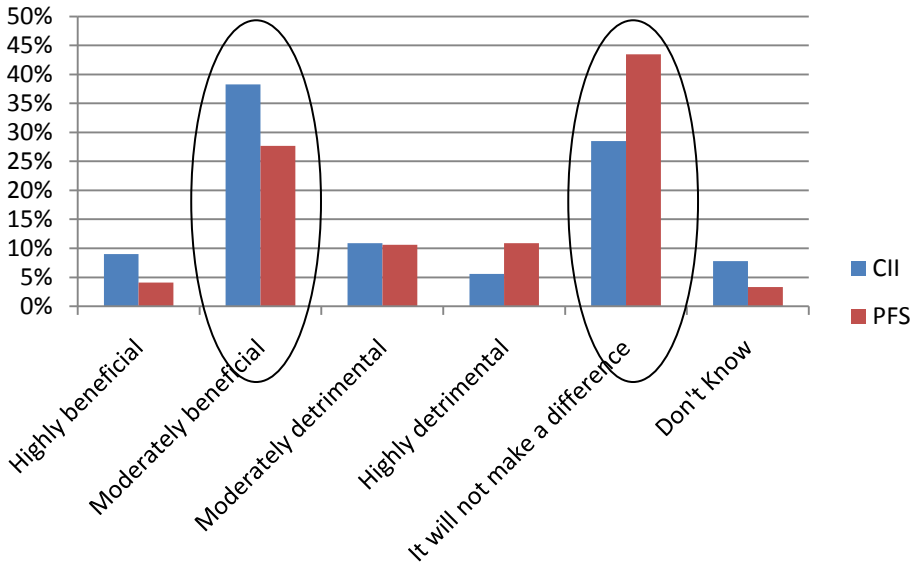
- 41.5% of respondents think that the „consumer champion" approach will be either highly beneficial or moderately beneficial.
- By contrast, 18.4% or respondents think that the „consumer champion" approach will be either moderately or highly detrimental.
- However a significant proportion (34.2%) believes that it will not make a difference.
- PFS members are more pessimistic about the benefits to be gained through the „consumer champion" approach than CII members. 38% of CII members think that it will be moderately beneficial by comparison to 28% of PFS members. In addition, 29% of CII members believe that the new approach will not make any difference by comparison to 43% of PFS members.

Overall CII Group Results



Sample size: **1,997**

Difference between CII and PFS responses

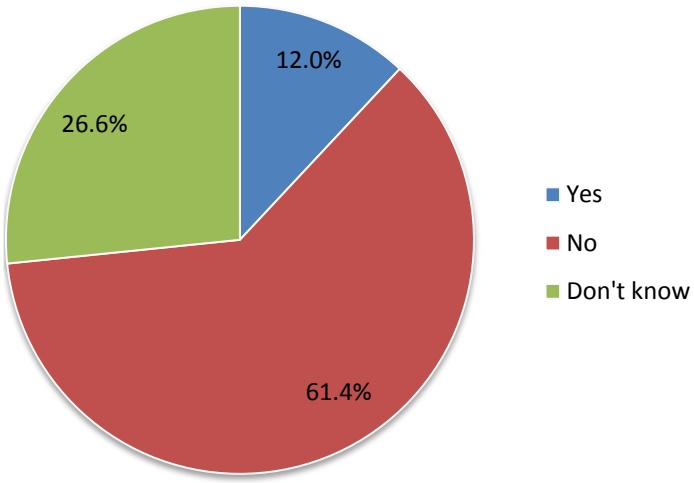


Q7: Do you think the new regulatory structure will be fully functioning in line with the objectives set out by the Government in time for the 2012 deadline

The vast majority of respondents do not think the timeframe for transition will not be sufficient

- 61.4% of respondents do not think that the regulatory structure will be fully functioning in line with the objectives set by Government.

Overall CII Group Results



Sample size: **1,984**

If you have any questions or comments on this consultation response please contact: Mr Ben Franklin, CII Policy & Research Co-ordinator: ben.franklin@cii.co.uk or by telephone: 020 7417 4782

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

Financial.reform@hmtreasury.gsi.gov.uk

14 April 2011

Dear Sirs,

CME Group Inc. (CME Group) appreciates the opportunity to comment on HM Treasury's (HMT) Consultative paper on "A new approach to financial regulation: building a stronger system" (the Consultation).

CME group is the holding company for four futures exchanges: the Chicago Mercantile Exchange Inc ("CME"), the Board of Trade of the City of Chicago Inc ("CBOT"), the New York Mercantile Exchange Inc ("NYMEX") and the Commodity Exchange Inc ("COMEX"). Our principal regulator in the United States is the Commodity Futures Trading Commission ("CFTC").

In the United Kingdom, CME, CBOT and NYMEX are recognised overseas investment exchanges and CME Clearing is a recognised overseas clearing house, the recognitions having been granted by the Financial Services Authority ("FSA"). In addition, CME Group has a wholly owned subsidiary, CME Clearing Europe Limited, which has recently been recognised as a clearing house by the FSA.

The Institutional Structure

Markets regulation

CME Group welcomes the Consultation's statement that the Financial Conduct Authority (FCA) will contain a strong markets function. In this context, we think that it is important that legislators are mindful of the significant differences in the regulatory approach to supervising markets on the one hand and providers of retail financial services on the other.

We welcome the proposal for a Markets Panel to underpin the markets regulation function. However, we think that the integrity of the markets regulation function and its role in macro prudential and resourcing discussions should be supported by further legislative underpinning.

In particular, we would support the following:

- Markets representation on the Financial Policy Committee (FPC) and the FCA"s Board (in this context, we welcome the appointment of Michael Cohrs, former co-head of corporate and investment banking and member of the Group Executive Committee at Deutsche Bank as an independent member of the interim FPC and regard this type of appointment as extremely positive) ;

- A requirement modelled on Schedule 1 of the Financial Services and Markets Act 2000 requiring the non-executive directors of the FCA to consider the adequacy of resourcing (i.e. by ensuring resources are utilised in the most efficient and economical manner) and operation (i.e. by ensuring the FCA is appropriately discharging its functions) of the markets function ; and

- A mechanism for allocating fees raised by those institutions supervised by the FCA"s Markets Division to markets regulation.

CCP regulation

CME Group understands HMT"s reasons for proposing that Central Counterparty Clearing Houses (CCPs) should be regulated by the Bank of England (BoE) given their systemic importance (although we do believe this gives rise to concerns about pre and post trade regulation not being joined up - see „Co-ordination of Supervision" below). If this route is adopted we would make the following suggestions:

- Careful thought should be given to how the supervisory style of the current FSA (open, approachable staff having a broad career development path through moving jobs within a large organisation) is reflected at the BoE. We think that staff who have broad markets experience are best placed to supervise CCPs. We have concerns that CCP supervisors may no longer have the flexibility to move between supervisory areas, even within the markets area, if they are employed by separate legal entities. This will be to the detriment of markets supervision as a whole. Consequently, it is of importance that practical cooperative measures are put in place between the BoE and FCA to minimise these risks. The BoE and the FCA may wish to consider the utility of staff secondments between them as a mechanism for ensuring coordination of their respective functions.

We notice the Consultation was silent on the funding of CCP supervision at the BoE. In our view, the part of the BoE which regulates CCPs should have its own discrete budget. In this context, we do not think that any fees in relation to CCPs should be available for other purposes within the BoE. At a minimum we believe that the basis of such fees should have at least the transparency of current Financial Services Authority (FSA) charging.

Competition

CME Group welcomes the Government's proposals to enable the FCA to play a credible and effective role in competition. We would however urge legislators to take steps to ensure that the various competition authorities do not have overlapping powers. If this is not avoided, there is a danger of confusion and uncertainty as to who is responsible for what in terms of competition scrutiny. We look forward to commenting on the more detailed proposals with regard to the FCA's competition remit at a later stage.

Co-ordination of Supervision

Given the current proposals to separate trade and post-trade infrastructure, we would make the following high level observations:

In principle, we welcome the proposal that the BoE and FCA should comply with the principles set out in the Consultation in relation to the co-ordination of the Prudential Regulation Authority (PRA) and the FCA. However, we think that the smaller size of the clearing function within the BoE means that these principles should be applied proportionately and it may be that less complex co-ordination mechanics are appropriate in this case. In this context, we think that a key principle should be to avoid overlaps in or inconsistency of, the supervisory approach between the BoE in relation to CCPs and the FCA in relation to markets.

There is a separate argument in favour of having a single regulatory point of contact for all of the „recognised" or „regulated" entities supervised by the FCA within our group. We think that consideration should be given to including this provision on the face of the legislation, although we recognise that this may ultimately be left to the FCA to decide.

It is important that the legislation provides for adequate information gateways between the BoE and FCA to share information on entities within the group.

We note that the FCA will be the UK's „voice" at the European Securities and Markets Authority (ESMA) and welcome the Consultation's recognition of the need to coordinate the work of individual regulators so that issues relating to CCPs are given appropriate representation by the FCA at ESMA. We regard this as of the highest importance given the proposed extent of ESMA's

powers in the latest draft of the Regulation on OTC Derivatives, Central Counterparties and Trade Repositories (EMIR). These powers cover all major aspects of clearing house risk management and client protection. We hope that careful thought will be given to reflecting this need for coordination in UK legislation.

Regulatory Change

Overriding Objective of the Bill

CME Group believes that, so far as possible, legislators should ensure the Bill is a mechanism for creating the appropriate institutional shape for the UK's regulation of financial services and markets. Doing this correctly will be a difficult, complex and lengthy process and should not be confused with the amendment of the substantive regulation of markets or CCPs.

To this end, we welcome the recognition in paragraph 2.129 of the Consultation that substantive changes to the recognition requirements for CCPs should be made as a result of EMIR. The same principle should apply to markets where changes will result from the review of the Markets in Financial Instruments Directive.

In light of the above, we would urge that the mechanics of grandfathering be kept as simple and "automatic" as possible.

Product Intervention

Whilst we welcome the recognition that product intervention is unlikely to be appropriate in relation to professional or wholesale customers, we are nonetheless concerned that the Consultation appears to envisage (at least theoretically) the possibility of product banning in the wholesale sphere with few checks and balances other than a set of principles to govern the intervention power. As a minimum we would therefore strongly suggest that:

> The legislation reflects a presumption that the powers would not be used in the wholesale sphere unless specific „triggers" have been breached; and
>
> There is a requirement to consult on the specific ban that is being proposed if the power is ever to be used in the wholesale sphere.

Competition

We note that the FCA has a competition objective but that the PRA does not have a similar objective. If our reading of the Consultation is correct (in that Multi-lateral Trading Facilities (MTFs) will be entirely regulated by the FCA) we think the objective should be welcomed to the extent it will level the playing field between MTFs and Recognised Investment Exchanges which are providing very similar services. However, there appears to be a lacuna in the proposals in that

Banks who operate Systemic Internalisers or trading mechanisms which may not fall within the MTF or regulated market definition, e.g. some of the broker crossing systems, may not be held to the same degree of competition scrutiny as markets and MTFs. This is because they will be PRA regulated for prudential purposes and the PRA will be under no obligation to consider competition in its supervision of these types of platforms, despite the fact that they will compete directly for business with markets and MTFs.

Enforcement

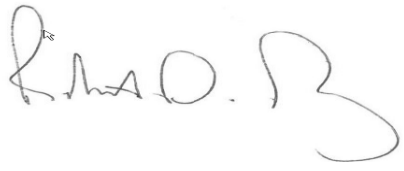
We note the intention to allow the FCA and BoE to be able to impose penalties on markets and CCPs respectively.

We are opposed to the proposal to allow early disclosure of supervisory or enforcement action (at the Warning Notice stage). There will be times when this has adverse effects on a firm"s reputation long before it becomes public that a regulatory action was without merit.

We would also urge legislators to ensure that these proposals - should they progress - are not extended to early disclosure of supervisory action against markets or CCPs. We believe in the right to be able to make representations before regulatory criticism becomes public and also believe legislators should be mindful of the specific market confidence and systemic stability issues that might arise should regulatory criticism of a market or a CCP become public prior to the market or the CCP having a chance to respond.

CME Group recognises the value of the consultative process undertaken by HMT during this key time of development of the UK regulatory structure, and appreciates the opportunity to play a part in offering its views. CME Group would be delighted to discuss the proposals and views offered in this response with HMT.

Yours faithfully,



Robert D. Ray
Managing Director, International Products and Services,
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Evidence

A new approach to financial regulation: building a stronger system

Response to HM Treasury from Citizens Advice

April 2011

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Introduction

Citizens Advice welcomes the opportunity to respond to HM Treasury and BIS consultation on building a stronger system of financial regulation.

The Citizens Advice service provides free, independent, confidential and impartial advice to everyone on their rights and responsibilities. It values diversity, promotes equality and challenges discrimination. The service aims:

- To provide the advice people need for the problems they face; and
- To improve the policies and practices that affect people's lives.

The Citizens Advice service is a network of over 400 independent advice centres that provide free, impartial advice from more than 3,000 locations in England and Wales, including GPs' surgeries, hospitals, community centres, county courts and magistrates courts, and mobile services both in rural areas and to serve particular dispersed groups.

The CAB service delivers a range of money related advice services, including: money guidance, which provides people with generic financial advice; financial capability, which provides people with the skills and knowledge they need to manage their money and choose financial products; and debt advice, which provide people with the information, advice and support they need to deal with unmanageable personal debt. Some of our debt advisers provide last minute advice and advocacy at court to people facing repossession or eviction for mortgage or rent arrears.

In 2009/10, the Citizens Advice service in England and Wales helped over two million people with over seven million problems, including 2.3 million enquiries about debt and over 140,000 about financial products and services.

In 2009/10, 14 per cent of CAB clients were from Black, Asian and Minority Ethnic backgrounds, and 23 per cent identified as disabled or having a long term health condition. Our statistics and case studies are drawn from the diverse communities we serve.

We have only answered those questions in the consultation which are relevant to our experience of financial services regulation.

Chapter 3: Prudential Regulation Authority

Q10: What are your views on the Government's proposed mechanisms for the PRA's engagement with industry and the wider public?

Citizens Advice believes that the PRA will need to communicate directly with consumers and consumer groups and should not just rely on the expertise of the FCA and its consumer panel. We believe that the PRA would also find useful to talk to other consumer groups on issues such as dampening the credit cycle.

Chapter 4: Financial Conduct Authority

Q11: What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the FCA?

We are disappointed that the FCA's strategic and operational objectives do not prioritise consumer protection and in fact the proposed strategic objective does not mention consumers at all. We believe that the strategic objective should be reworded as follows (changes in bold):

"protecting and enhancing **consumer** confidence in the UK financial system"

Our concerns about the operational objectives are as follows:

Facilitating efficiency and choice in the market for financial services

The consultation does not make it sufficiently clear what the FCA is expected to do to meet this objective. Paragraph 4.15 states that this objective is connected to issues like pricing, delivery and an appropriate degree of choice, but these are not connected to any specific outcomes for consumers. We think what this objective is trying to say is that the FCA should have an operational objective of ensuring that markets work well for consumers in terms of providing an appropriate range of products that meet consumer needs and provide good value for money. However, the paragraph blurs this in to issues of competition and regulatory barriers in a way that makes this a very unfocussed objective.

Citizens Advice believes strongly that this objective should be reworded to state that the FCA should ensure that the financial services market works well for all consumers. For example, we have seen how competition alone may not give vulnerable consumers choice or value for money with products such as transactional banking. Alternatively competition can serve to confuse consumers with an unnecessarily complex array of products and product features such as payment protection insurance.

We are disappointed that the Government does not think that the FCA should have a financial inclusion objective. In this response, we will point out several times that the new regulator should have a clear mandate to address discrimination in the provision of financial services and to promote diversity, equality and meeting the needs of vulnerable and marginal consumers.

Securing an appropriate degree of protection for consumers

We note that this seems to replicate one of the FSA's current objectives. We do not entirely agree with the analysis that previous failure by the FSA to deal with emerging consumer problems was solely due to insufficient focus on consumer protection. We argue that the FSA did not always have a clear vision of what an appropriate degree of protection for consumers should look like. By simply restating the previous objective, there is a possible danger that this problem will not be tackled sufficiently. While we understand the concern raised by the Treasury Select Committee that the regulator should not be actively branded as a partisan consumer champion, we still believe strongly that the new regulator will have to show itself to be an effective consumer champion when necessary.

Therefore we believe that the Government and the FCA need to do more to explain what this objective will mean and how it will be secured If this cannot be done in the legislation itself, the Government should give a commitment to supplement this and other objectives with statutory guidance on the expected approach of the regulator.

We would also like to reiterate the point we made in our response to HM Treasury and BIS's consultation on reforming the consumer credit regime, that it is necessary for the FCA to relate to the wider, and particularly local, enforcement community who may have concurrent enforcement powers. We believe that the FCA should consider funding local trading standards officers to undertake enforcement on their behalf.

Protecting and enhancing the integrity of the UK financial system

This seems appropriate, however the Government and FCA will need to consider how this objective fits with the one on consumer protection. We consider that this objective could have the potential to conflict with the consumer protection principle above. For instance, financial services providers may and will argue that any particular consumer protection initiative could undermine the integrity of the UK financial system by opening providers up to regulatory risk, undermining competition and weakening the UK financial industries' position against international competitors and so on. If the FCA is to properly defend consumer interests, it will need to be able to act without giving undue attention to unjustified concerns from the financial services industry. Therefore the Government might need to spell out what this may mean.

Promoting competition

Citizens Advice agrees that the FCA should have promoting competition in its remit, however, this should be balanced by a strong requirement to take effective action to tackle the failures of competition. As we highlight above, it is our experience that competition does not drive choice in the financial services market for vulnerable and low income consumers. We are concerned that paragraphs 4.20 – 4.22 do not mention the failures of competition in markets such as payment protection insurance, transactional bank accounts.

Our comments about the proposed regulatory principles

Efficiency

Whilst we agree that the regulator needs to use its resources in the most efficient and economic way, we are concerned that this could prevent the FCA tackling financial services problems for the most disadvantaged consumers. These might be quite small groups of people who are experiencing serious detriment from regulated firms which may require an intervention by the FCA where the costs may appear to outweigh the consumer benefits. It will be important for the FCA to be able to do this where the affected consumers are protected by the Equality Act 2010. One of the reasons that markets will fail more vulnerable consumers is that the costs of providers to meet the needs of vulnerable consumers may outweigh the apparent economic benefits those consumers receive. Therefore a diversity and equalities approach to ensuring that financial services markets provide choice may require an approach that does not meet the constraints of a narrow interpretation of cost-benefit analysis.

Proportionality

We agree that proportionality is an important regulatory principle for the FCA. However, one of the most significant failures of the current system is the inability to take swift surgical regulatory action to tackle serious consumer detriment. Where there is clear evidence of emerging consumer detriment (particularly where this relates to a small market sector eg consumer credit), requiring the regulator to do a full cost benefit analysis could slow necessary action down. We believe one of the key challenges of this review is to put in place mechanisms for the regulator to take quick and targeted action. We believe this is particularly important for vulnerable consumers who may find it more difficult to complain and could therefore continue to experience detriment. We therefore believe that the FCA's proportionality objective needs to take this into account.

Consumers being responsible for their own decisions

We recognise the importance of consumers taking responsibility for their own decisions. However, the key point here is that those decisions are properly informed and not made in circumstances of financial difficulty or other pressure that could lead them to take decisions that they would not have taken otherwise. This is not just about financial capability – a particular feature of most financial products is that they create long-term relationships and obligations.

Consumers will usually be at a disadvantage in understanding how contingent risks and their future circumstances could affect the future suitability or affordability of any particular product. For instance, the disproportionate number of sub-prime mortgage borrowers that faced mortgage arrears and repossessions highlights the risks and nature of obligations were not properly explained or made clear to consumers. Consumer responsibility in the context of regulation ultimately comes down to a question about when consumers can get redress for mis-selling or other conduct failure. There is a boundary line, but it cannot easily be drawn unless the Government is confident that consumers are in fact put in a position by firms to make informed decisions.

Whilst we agree that CFEB/the Money Advice Service has a duty to improve consumers' financial skills and confidence, we would urge the FCA to retain and build on its consumer education about their rights. We very much welcome the work recently undertaken by the FSA on this issue – e.g. the leaflet "know your rights" on payment services.

Responsibilities of senior management to ensure compliance with the regulatory framework

Citizens Advice very much welcomes this regulatory principle. In our response to the joint FSA/FOS consultation on complaints handling last year, we welcomed the proposal to nominate a senior individual to have overall responsibility for complaints handling. In our response to this consultation, we suggested that the firms should be required to publicise who the nominated person is to consumer groups to enable them to raise concerns with senior policy makers in large firms easily. We believe that our experience of dealing with consumer problems could and sometimes should form a key part of any objective root cause analysis by firms. Establishing a firmer expectation that firms would take evidence

of consumer problems on board at a senior level and respond to concerns raised would mark an important step forward in improving consumer confidence in financial services.

We believe that this proposal should go further in that the FCA should expect each firm to appoint someone at a senior level to meet the needs of vulnerable consumers. Given the proposals later in this consultation for the FCA to have powers to vet and ban products, we believe this will be important.

Openness and disclosure and conducting regulation as transparently as possible

We agree that both these regulatory principles are very important.

Final comments on this question

Equality and diversity

In our response to the initial Treasury consultation about financial regulation, we asked the Government to modify its consumer protection objective to ensure that the needs of vulnerable and consumers and consumers from minority groups are properly addressed. It is disappointing that paragraph 4.31 states that the Government has ruled out diversity as being one of the regulatory objectives of the FCA. The paragraph states this is discussed in Chapters 3 and 5 of the consultation, but we have not found anything in either of those chapters which relates to equality and diversity. We would like to reiterate what we said in our response to the first consultation on financial regulation, that the FCA should be empowered to intervene as necessary to ensure that the needs of specified groups of consumers are being met as the broader social benefits of fairness and inclusion will otherwise be undervalued.

This could be achieved in legislation by:

- Requiring the FCA to identify groups of consumers (including those with protected characteristics under the Equalities Act 2010) who are likely to be disadvantaged in relation to financial services because of some characteristic of that group.
- Requiring the FCA to intervene to ensure that any such disadvantage is avoided so far as is reasonable.
- To modify the proposed requirement not to impose a burden of firms that is disproportionate to the benefits.

Payment Services Regulations

We have recently discovered that the Office of Fair Trading has a duty in the Payment Services Regulations 2009 to investigate complaints about access to basic payment services. As the Government proposes to transfer the responsibilities of the OFT to a single competition regulator, we believe that the FCA would be best placed to take up this duty.

Q12. What are your views on the Government's proposed arrangements for governance and accountability of the FCA?

We would like to see the governance and accountability strategy for the FCA to prioritise consumer protection and to ensure that consumer interests are always championed by the regulator.

Over the last few years, we have noticed a welcome change in the governance and leadership of the FSA compared to pre-2008. As the FCA's objectives do not seem to be much different to the FSA's, we believe a governance strategy is needed which prioritises consumer concerns. We believe the key elements of such a strategy would need to include the following:

- If the FCA is to champion consumers' interests, the FCA board must be constituted to ensure that the consumer interest is the majority interest of the FCA.
- In addition we believe that the FCA needs to develop an effective consumer engagement and advocacy strategy to ensure that consumer voices and concerns are heard at the heart of the regulatory regime. We are disappointed that, in paragraph 4.42, the Government **expects** rather than **requires** the FCA to engage directly with consumers. We reiterate the points made in the first HM Treasury consultation on financial regulation that the FCA should be engaging with all consumer advocacy groups fully and often (not just the Consumer Panel). It also means developing a strategy for the FCA to engage with consumers directly. It needs to work hard to understand consumer concerns, needs and problems and then work harder to ensure that the retail financial services sector changes to take better account of these where necessary.
- The FCA needs to be more transparent in its dealings with consumers. This means being prepared to publish full details of reviews and research – not just one page summaries. It also means alerting consumers to problems in the market and problems with particular firms earlier and better than is currently the case. For this reason, we welcome the intention to publish warning notices.
- Finally, we believe that the FCA needs to have a duty to take action on and deal with problems in the market in an agreed time period. This should be a duty similar to that of the Competition Commission to remedy consumer detriment as far as is reasonable and practicable and to develop remedies within a specified time on receiving a complaint or becoming aware of significant consumer problems. For example, it took the FSA several years to act on evidence of irresponsible lending and unfair arrears practices by sub-prime mortgage lenders.

Q13. What are your views on the proposed new FCA product intervention power?

Citizens Advice strongly supports the FCA having this power, as this could help prevent consumer detriment from happening in the first place. Working with firms to spot the features of products that could cause consumer detriment and pre-empting these before they come to market is a better approach than just relying on enforcement and redress to clear up after problems have occured This power would also work well should the Treasury's proposals on simple financial products come to fruition.

For this power to work well, the Government would need to set out clearly what the FCA's powers would be in this area and how they would work. We believe that they should not only be to ban products or features of products, but also to adapt products or features of products to ensure that they meet the needs of all consumers. Again we think that there is a very important point here about the regulator's role in ensuring that choice means meeting diverse needs and ensuring that people with characteristics protected by equalities legislation have their needs properly taken into account.

Q14. The Government would welcome specific comments on:

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

We strongly agree with the Government's proposals to allow the FCA to use transparency and disclosure as regulatory tools. We have been frustrated at times by the FSA's inability to disclose regulatory and enforcement action. For example, the FSA publicly announced in August 2008 that they had found unfair lending and arrears management practices by sub-prime mortgage lenders and that some lenders would be referred to enforcement. However there was no indication as to who these lenders were. This could have been of significant importance for consumers who were being threatened or facing court action for possession by those lenders who may have had grounds to either counter claim for breach of FSA rules arrears and possession practices or to initiate a complaint to the Financial Ombudsman Service. Again we welcome the proposal to allow the FCA greater transparency to inform consumers about the conduct of firms at an earlier stage.

We very much welcome the proposals to allow the FCA to require firms to withdraw misleading financial promotions. We believe this power will be vital to deal with mis-leading advertising of mortgages and secured loans, consumer credit products, claims management and debt management services.

The approach to this power outlined in paragraph 4.83 seems sensible.

Q15: Which, if any, of the new additional powers in relation to general competition law outlined above would be appropriate for the FCA? Are there any other powers the Government should consider?

We warmly welcome the proposals to give the FCA a better competition mandate than the FSA currently has. We would welcome further detail of what the FCA's competition powers will be.

We note that paragraph 4.96 suggests that an alternative to MIR powers would be to give an appropriate body the ability to trigger the supercomplaint process and suggests that this body could be the Consumer Panel. We do not believe that it would be appropriate to allow only one consumer advocate to do this. Our concerns in relation to limiting this role to the Panel, as it is currently constituted, are that it is only an expert advisory panel and does not have access to evidence from consumers in the market place or a remit to represent live issues affecting consumers and seek remedies.

Furthermore, with the abolition of the OFT, there will be a need for a regulator to deal with supercomplaints on financial services, which have arguably generated the biggest number of supercomplaints so far (Cash ISAs, cold calling and up-front charges, credit card interest rate, home credit, NI banking, PPI, credit and debit card surcharges).

Therefore we would like to see the FCA placed under duties similar to those set out in the Enterprise Act 2002 which require specified regulators to:

- Respond to complaints by designated consumer bodies that a feature or features of a market is, or appears to be, significantly harming the interests of consumers. For instance section 11 of the Enterprise Act 2002 provides a set statutory period for the regulator to publish a response stating what action (if any) it will take along with reasons for its decision.
- Take action to remedy any consumer detriment identified as completely as is reasonable and practicable within a specified timeframe. For instance section 137 and 138 of the Enterprise Act require the Competition Commission to do this within two years of a market investigation reference – a year might be a suitable timeframe for the FCA.

Citizens Advice believes that a route for external organisations to ask the FCA to investigate problems in the market and a clear duty for the FCA to quickly remedy consumer detriment are key. Without this the requirement to use resources in the most efficient and economic way could actually be a prescription for not taking the necessary action to deal effectively with consumer detriment.

Chapter 5: Regulatory process and co-ordination

Q18. What are your views on the Government's proposal that the PRA should be able to veto an FCA taking actions that would be likely to lead to the disorderly failure of a firm or wider financial instability?

Citizens Advice is concerned about the implications of the proposal to allow the PRA to veto the FCA taking actions that might lead to the disorderly failure of a firm or wider financial instability. We believe that this could give the green light to firms to make largely unjustified complaints that FCA regulatory action could undermine their stability if they have to compensate consumers for unfair practices. This will undermine consumer confidence in the regulator. It would be reassuring if the Government were to set out clearly the limited circumstances in which such a veto would be appropriate, and more importantly the safeguards that would be put in place to ensure that:

- Consumer detriment does not continue to grow because of the veto or the delay in the FCA taking action to deal with consumer detriment on conduct issues;
- Consumers are compensated for any delay in seeking redress as the result of any veto or delay.

Q19: What are your views on the proposed models for the authorisation process – which do you prefer, and why?
Q20: What are your views on the proposals for variation and removal of permissions?

We have no particular concerns about the proposals to require authorisation before permission, or that this might be divided between the two regulatory authorities. However, we believe that the process of authorisation, particularly if this is the point where threshold conditions are considered, needs to be closely connected to the permissions that are being sought. We have seen problems in consumer credit where firms were previously able to seek permission to carry out a wide range of controlled credit activities where the licencing process did not give due consideration to the firm's competence or standing to provide each of those services.

As we outlined in our response to the consultation on the future of consumer credit regulation, firms will need to have correct permissions for the type of business rather than a blanket permission. This is because section 39 of the Consumer Credit Act provides that **trading** without the right sort of licence is illegal, and under section 40 any loans made by a trader lending without the right sort of licence cannot be enforced except with leave of the OFT. In comparison, whilst section 19 FSMA states that trading without authorisation is illegal and any agreement made by the unauthorised person/firm is unenforceable, section 20 states that trading without the correct permission is not an offence, and does not make agreements unenforceable. Given the range of consumer credit businesses, we believe that this will need to be reconsidered for consumer credit.

Variation and removal of permissions in paragraphs 5.41 – 44

In our response to the consultation on the future of consumer credit regulation, we highlighted the need for the new credit regulator to be able to take very quick micro-intervention to deal with specific practices or firms. We stated that the current CCA requirements regime could provide the basis for this, if combined with a rule-making power.

We believe that the FSA's approach to variation and removal of permissions outlined in paragraph 5.42 using own initiative variation of permission (OIVoP) could do this, but we think this might need to be amended to make it truly effective. For instance:

- It is not clear how OIVoP would bite on a firm's conduct – would it impose conditions or requirements on the way they carried out an activity under the permission?
- Would any such condition or requirement have the force of a rule in so much as consumers would be able to seek redress for any detriment arising from a firm's failure to meet that condition or requirement?
- Would the process be public and transparent, so that consumers and their representatives will be aware of the requirements or conditions imposed by the regulator on the firm?
- Would a failure to meet such requirements or conditions be capable of challenging authorisation or otherwise lead to enforcement action?

Q21: What are your views on the Government's proposals for the approved persons regime under the new regulatory architecture?

These seem to be appropriate. We have no particular comments to make.

Q22: What are your views on the Government's proposals on passporting?

We broadly agree with the proposals set out in paragraphs 5.50 – 53, with the proviso that the UK Government assumes that the FCA can tackle any bad practices by passported firms and UK consumers are entitled to redress for these.

Q24: What are your views on the process and powers proposed for making and waiving rules?

We believe that there will have to be extremely good reasons for the FCA to apply rule waivers to firms or groups of firms. We suggest that the Government should consult on how this process might be applied, especially if consumer protection affected.

Q28: What are your views on the Government's proposals for the new authorities' powers in respect of fees and levies?

We have no particular concerns about the fee structure set out in the consultation, other than we would expect the current relationship between the size of the fee and the size of the firm to be maintained and replicated for consumer credit. Given that there will be two regulators (prudential and conduct), it will be important for the Government to ensure that the FCA will be properly resourced, particularly if it is to take on regulation of consumer credit which has been woefully under-resourced for many years.

Chapter 6: Compensation, dispute resolution and financial education

Q29: What are your views on the proposed operating model, co-ordination arrangements and governance for the FSCS?

As we outlined in our response to the initial Treasury consultation on financial regulation, we believe that there should be a single portal for consumers.

Q30: What are your views on the proposals relating to the FOS, particularly in relation to transparency?

We largely support the proposals about the role of FOS in this consultation. However, we are disappointed that there is no requirement on the FCA to have regard to FOS's complaints data to inform their regulatory action against firms. We think that the Government should introduce a procedure similar to the current supercomplaint procedure where the complainants would include FOS, the Consumer Panel and other relevant current supercomplainants (the power to designate supercomplainants should be replicated either by HM Treasury or the FCA itself.

We very much welcome the proposal in paragraph 6.23 to clarify FOS's role in publishing its determinations. We believe that FOS decisions are useful and can help drive good practice by firms.

Q31: What are your views on the proposed arrangements for strengthened accountability for the FSCS, FOS and CFEB?

The only comment we would make in relation to the proposal to require these bodies to be audited by the NAO is that it will need to have a good understanding of the public benefit of the important services these bodies provide. We are particularly concerned that without this, the NAO could accept without question the concerns aired in the recent Treasury Select Committee inquiry on the future of financial regulation as to whether consumers should have to pay a fee to access FOS.

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David McIntosh QC (Hon)
Chairman

14 April 2011

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

Dear Sirs

Re: CLLS Regulatory Law Committee response to Her Majesty's Treasury Consultation: A new approach to financial regulation - building a stronger system (CM8012)

The City of London Law Society ("**CLLS**") represents approximately 14,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world.

This response to Her Majesty's Treasury Consultation: A new approach to financial regulation - building a stronger system (CM8012) (the "**Consultation**") has been prepared by the CLLS Regulatory Law Committee (the "**Committee**"). Members of the Committee advise a wide range of firms across and outside Europe who operate in or use the services provided by the financial markets, These include clients on all sides of the market as well as market infrastructure providers. We are frequently involved in advising overseas firms who are seeking to establish a European presence and who are considering the U.K. as a possible lead jurisdiction, as well as advising a wide range of firms and individuals on enforcement matters. Our comments below on the authorisation and enforcement processes are therefore based on considerable practical experience.

1. GENERAL

We are not commenting on every question raised in the Consultation and have set out our comments below with reference to the question numbers concerned. We highlight in this section two areas of general concern, the first relates to the day to day operation of the new authorities, the second to the proposed change in approach on certain matters involving regulatory decisions

As explained in our previous comments we have not questioned the policy of creating a new regulatory infrastructure as this is clearly settled, but a structure involving more than one regulator carries clear risks of lack of effective coordination and related cost and uncertainty for firms. The implementing legislation must set a clear framework within which the authorities must operate and co-operate, to provide the markets and firms with the efficient and cost effective regulation that they need. If the U.K. is to remain a leading jurisdiction for the location of financial services firms then it must provide them with clear, effective and efficient processes for authorisations, variations of permission, approved person approvals and change of control consents, as well as fair processes in enforcement cases. Firms that have a choice as to whether to locate here (with the resulting jobs, tax revenue etc.) take into account the local processes when determining whether to base their head office in the U.K. or set up elsewhere in Europe and simply passport into the U.K. We know this from our own practices. The impact of the new structure on firms must be capable of being clearly described, so that firms know what to expect, who to deal with, and what time frames will apply. The proposals in the Consultation do not go far enough to ensure that this will be the result. We suggest below that there should be express duties to cooperate, a shared services function and identical rules where both regulators are implementing the same European laws, or making rules which cover the same territory. As far as European laws are concerned it is essential to avoid a position where different regulators appear to interpret the same rules in a different way, as in other Member States there will be one authoritative source.

We have already expressed to you our serious concerns about the proposals in relation to various changes in the provisions relating to enforcement and similar matters, such as refusals to approve individuals. We are strongly opposed to the proposals in their current form, as explained in our comments on the specific questions below. We highlight in this general section the concerns we have on the proposal to publish warning notices. We consider that it is unjustified, unfair and unnecessary. If the Government proceeds with it then it

will need to make significant changes to the entire framework within which they are produced. At present warning notices are highly selective as to their content, omit relevant material which does not assist the "prosecution" case and they are issued before the firm or individual has had access to the material which the FSA has in its possession or an opportunity to challenge what the notice says.

The suggestion that warning notices should be made publicly available is not justified. If the regulator has a case then it will appear in due course. In our experience, even when a warning notice is followed by a Decision Notice, the content is often materially different. As a recent public example has shown, premature publication of information about an investigation can have a devastating irreversible impact that is particularly unfair if the investigation concludes with no action. The same could happen with publication of warning notices-not every warning notice results in a Decision Notice. We urge HM Treasury to revisit these proposals, which also have a potentially damaging effect on confidence in the U.K. and on the reputation of the U.K. as a place to carry on business. We are of course supportive of an effective and appropriate enforcement process, it is essential that firms and individuals who break the rules are subject to proper sanction and, where appropriate, publicity, but the current proposal is not required to meet that objective.

2. BANK OF ENGLAND AND FINANCIAL POLICY COMMITTEE

In our response dated 15 October 2010 to consultation paper number CM7874 "A new Approach to Financial Regulation: Judgement, Focus and Stability" we deliberately made no comment on the creation of the FPC as a matter of principle. We express no view on that in this response either but we have a number of concerns in relation to the proposed role for the FPC, its accountability and the proposed power of direction in particular. These largely fall under question 3 and we are accordingly setting out our response in relation to that question first.

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

2.1 The FPC's proposed objective

We note that the Bank of England is to be given a revised financial stability objective, which will be to "protect and enhance" the stability of the financial system of the United Kingdom. The FPC's objective will be designed to link into the Bank's objective by requiring it primarily to identify, monitor and take action

to remove or reduce systemic risks with a view to protecting and enhancing the resilience of the UK financial system. These objectives appear to envisage a continuous requirement to improve the level of financial stability in the UK, with no "steady state" ever being reached. The consultation paper says in paragraph 2.19 that the Government proposes to build a balance between financial stability and sustainable economic growth into the FPC's main objective as set out in Box 2B. The proposed wording in paragraph 4 of the FPC's objective is somewhat timid in this regard. The FPC is not required or authorised to exercise its functions in a way that would "in its opinion" be likely to have a significant adverse effect on the capacity of the financial sector to contribute to the UK economy in the medium or long term. This is highly subjective and would give the FPC wide latitude.

This is underlined by the proposal in paragraph 2.23 that the Government will legislate to give the Treasury a discretionary power to provide the FPC with guidance in the form of a remit. We consider that the balance to be struck between financial stability and sustainable economic growth is quintessentially a political judgment for a democratically elected Government, and not one for the Bank of England or the FPC. The balance requires respective weights to be accorded to the risks to businesses, households and individuals of financial instability and the economic benefits generated for the UK as a whole by its financial services sector. That balance may change over time. We consider that the legislation should oblige the Treasury to set the FPC's remit, and that the tension between stability and growth be acknowledged in the FPC's remit more clearly. The FPC should be required to respond to the remit, setting out how it proposes to implement it. Simply requiring the FPC to take the Government's views into account would be insufficient.

This issue is relevant to the factors to which it is proposed to require the FPC to have regard. The consultation paper says in paragraph 2.20 that proportionality captures the need of the FPC to consider the likely benefits of its actions compared to the costs they would impose. While this may capture whether an individual intervention is, of itself, proportionate, it begs the question of the aim being pursued by the intervention. It is generally a requirement of proportionality that the measure pursues a legitimate aim. We do not consider that the proposals in relation to the FPC's remit go far enough in providing for the Treasury to identify the aims to be pursued by the FPC.

The legislation will clearly contain a large number of provisions relating to coordination between the FPC, the Treasury, the PRA and the FCA. Objective 2 says that that the Bank shall "aim to work with" other relevant bodies. While

we note that these words appear in the Bank's current financial stability objective, in the light of the Government's view of the failure of the Tripartite system introduced by the previous Government we do not consider that this is sufficiently ambitious or robust in relation to the operation of the new regulatory architecture. The relevant bodies should be required to work and cooperate with each other.

2.2 Exercise of functions

Paragraph 2.26 provides that the proposed levers at the disposal of the FPC need not be used in any particular order. We query whether this is the right approach (especially if the Government takes the view that the actions of the FPC are not justiciable for the purposes of judicial review – see below). In the recent financial crisis, risks in the system did not arise overnight. Early, graduated intervention may have been effective in significantly influencing market behaviour. And given the potentially invasive use by the FPC of its tools, we do not consider that it would be appropriate to provide the FPC with complete discretion. While we accept that it will be overly mechanistic to require the FPC always to exercise its powers in a set order to address a particular issue, we consider that the FPC should also be obliged to act here in accordance with the principle of proportionality. That is to say that it should be required to consider, before using its power to direct, whether its objective could not be attained by using a less invasive power/use the least invasive power to achieve the particular aim.

2.3 Accountability

Paragraph 2.28 of the consultation paper says that the Government proposes to legislate to exclude individual regulated firms from the FPC's powers. It is recognised in paragraph 2.29, however, that the FPC's macro-prudential interventions may be aimed at a small number of large institutions – perhaps only one or two - that could pose systemic risk. The paper does not propose any specific way of addressing this but merely says that the FPC will need to be aware of the potential for its activities to overlap with the regulators' own responsibilities for supervising individual firms and must take care to ensure that the firm-specific decisions continue to be taken by the line regulator. It is proposed, however, that the FPC be given a power to direct the PRA or FCA to implement measures imposed using the macro-prudential tools. There is no mention of the rights of firms to challenge such measures.

Paragraph 2.97 differentiates between two types of use of the FPC's power to direct. High level directions requiring the PRA or FCA to use their discretion to

determine how the FPC's aim can best be achieved are contrasted with the very specific use of the direction making power, requiring no discretion whatsoever on the part of regulators to implement it. Some of the macro-prudential interventions proposed could (if they were effected by the FSA under the current law) require the use of its FSA OIVoP powers under section 45 of FSMA if aimed at one or two institutions. In that event, an affected firm would have the right to refer the matter to the Tribunal. It is not clear precisely what (if anything) the Government is proposing here in relation to the rights of firms. If the PRA or FCA are given no discretion whatsoever by a direction of the FPC, then it appears unlikely that a firm would be able to challenge the measures implemented by the regulator in compliance with that direction. We imagine that any attempt to bring judicial review proceedings against the FPC would be met by the argument that its actions are not justiciable on the grounds that they concern matters of economic policy, notwithstanding that they affect very few firms. And in any event it appears unlikely that a court would be prepared to second-guess the FPC on matters within its expertise, taking into account the high threshold in actions for judicial review. However, the less discretion that is accorded to the regulators and the more a "one size fits all" approach is adopted by the FPC in the use of its direction making power, the more important it is that firms have a proper right to challenge matters that affect them. The alternative (as mentioned in paragraph 2.97) would be for the directions of the FPC to be expressed broadly and be binding on the PRA and the FCA as to the overall outcome to be achieved. The regulator would then have a discretion as to how it acted but firms would (we assume) have the same safeguards as apply currently. We consider that this approach is preferable and that the FPC should be required to use it unless giving the PRA or FCA a discretion in the particular case would be prejudicial to financial stability.

We broadly agree with the proposals in paragraphs 2.94 to 2.97 in relation to consultation. It is important to financial institutions, their investors and their counterparties that there is as much clarity as possible in relation to how the FPC's powers may be used. We note, however, that there will not necessarily be a requirement on the FPC to consult on a policy statement in advance of using a particular tool. It is proposed in paragraph 2.94 that the Treasury should specify, when setting out the FPC's toolkit in secondary legislation, whether the FPC should publish and consult on a policy statement in advance of using the tool and whether existing PRA and FCA procedural requirements should apply when implementing that tool. We do not agree that the secondary legislation should set out on a once and for all basis that there will, say, be no consultation whatsoever on certain uses of the direction making power. We would be concerned that this could lead to an approach whereby the more

coercive the tool is, the fewer safeguards would apply. The argument would be that such a tool would only be exercised in an emergency and it would be prejudicial to financial stability at that point for the authorities to have to comply with procedural safeguards. We see no reason why following enactment of the legislation the FPC could not be required to consult on a policy statement in relation to the use of all of its tools. In the case of the power to direct, it could be required to consult on a policy statement in advance of using the power, subject to an exception where the delay would be prejudicial to financial stability. The same would apply to consultation by the PRA and FCA. As set out above, we do not consider that systemic risks build up overnight. The presumption in relation to consultation should in our view be that procedural requirements will generally apply unless the circumstances genuinely warrant a departure from the norm, based on objective and predefined criteria.

It is recognised in paragraph 2.75 that the mechanism for creation of an ad hoc tool will rarely – if ever – need to be used. It is not clear from paragraphs 2.72 and 2.73 precisely how the mechanism would be used. Paragraph 2.72 refers to the possibility of the PRA or FCA refusing to comply with a recommendation of the FPC because they do not have the power to carry out the action proposed or because they believe that it would have significant unintended consequences. In the case of the latter is not clear whether the solution proposed in paragraph 2.73 would also involve extending the powers of the PRA or FCA in order to give them the legal powers to comply with the direction. We hope that is not what is being suggested. The creation of an entirely new tool, without warning, would be a radical step and potentially prejudicial to financial stability in itself. The ability to extend regulators' legal powers at the same time would be highly damaging to legal certainty.

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

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

We do not consider that we can comment on the likely effectiveness of the macro-prudential tools generally without greater detail as to their scope and operation.

We note that the proposed tools are very specific but that they are to be focused on system-wide, rather than firm specific, characteristics. However, as mentioned above, we note that the Government accepts that, in practice, a macro-prudential intervention may be aimed at a very small number of systemic

institutions. This seems to us to present a tension. Measures aimed at a very small number of institutions but applied on a "one size fits all" approach may operate unfairly. Different firms could be affected in different ways, perhaps disproportionately, by the same measure. However, if directions are focused very narrowly, there is a risk of the FPC assuming the role of the regulators. Paragraph 2.53 refers, for example, to the possibility of targeting capital requirements specifically on certain sectors or assets, recognising that correctly identifying the source of the risks would be an information-intensive process. In our view, this underlines that the FPC should generally be required, when exercising the power of direction, to give the regulators discretion as to how they implement the FPC's aim in using the particular tool in relation to individual firms.

There is very little in the Consultation Paper on how the arrangements would work where the power of direction is used in such a way that the PRA or FCA have no discretion. Complying with measures imposed by the PRA or FCA as result of the direction by the FPC may not necessarily be easy to implement quickly by affected firms. In some cases, they may be subject to contractual obligations that prevent them from doing so. For example, setting haircuts at a particular rate in repo transactions may require a UK authorised firm to breach its contract with a counterparty who is not subject to the same requirements. We are assuming that there is no suggestion that measures implemented in response to directions would have an impact on existing contractual arrangements.

3. PRUDENTIAL REGULATION AUTHORITY

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

The formulation of a clear strategic objective is essential in setting the context for the scope of the PRA's rule making and other powers, particularly given the lack of clarity elsewhere in the paper as to what should be regarded as prudential matters falling within the remit of the PRA and what should be considered as conduct matters to be dealt with by the FCA. Accordingly, we agree with the principle of having a clearly expressed set of objectives and with the general concept of setting out factors to which the authorities should have regard, rather than expressing these as secondary objectives.

However, we question the formulation of paragraph 4 in Box 3A. It seems to us incorrect to say that promoting the safety and soundness of PRA authorised persons "includes" seeking to minimise any adverse effect that failure of that

person could be expected to have on the UK financial system. Rather, even if the PRA had failed to ensure the safety and soundness of an authorised person, it would not have failed in its strategic objective to the extent that the effect of that person's failure was minimised. Accordingly, it would seem preferable for paragraph 4 to be set out as a separate operational objective. Furthermore, it seems odd that the PRA does not have an obligation to advance its strategic objective but merely to act in a way that is compatible with it. We consider that it would be preferable to state that the authority is obliged to advance its strategic objective through either or both of its operational objectives.

In relation to the proposed regulatory principles:

- in relation to principle 3, we question the use of the word "general", which is not used in relation to any of the other principles. If there is any particular implication to be read into the use of the word here but not in principles 2 and 6, we consider that it should be stated explicitly;

- we do not consider that principle 5 (making information relating to authorised persons available to the public) is appropriate to be stated as a regulatory principle. Although this may be an appropriate tool to use in particular circumstances (as to which we comment in response to question 14 below), it does not seem to have the status of a general principle to be borne in mind generally by the authority in advancing its objectives. Underscoring this point, the use of the expression "in appropriate cases" makes the principle so vague and discretionary as not be helpful either as a guide to the authority or as a means of holding it to account;

- we consider that principle 6 should be expressed more strongly as a general obligation to exercise functions transparently, subject to a limited exception indicating the types of circumstances that would justify non-disclosure;

- we would urge the Government to reconsider its conclusion not to include as a principle the desirability of facilitating innovation. Although we recognise that some consider that undue weight may in the past have been given to this objective in its current form in section 2 of FSMA, we do not consider that this is a good reason for omitting the principle altogether. Without such a principle, it will be difficult for supervisors to give any weight to the benefits for users of financial services of new products and services, as against any risk to firms or consumers that they may pose. Clearly there is a need to weigh the risks against the rewards, but to omit the principle altogether indicates that the rewards are simply not taken into account. We suggest

that the principle should be included but reformulated, for example by referring to encouraging the development of a financial system and markets which respond to the needs of their users.

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

We are concerned that the decision as to whether to subject an investment firm to the supervision of the PRA is to be taken by the PRA itself. There is a clear conflict of interest in permitting the PRA to determine the scope of its own jurisdiction in relation to particular firms. We also wonder what procedures there would be for conversion of a firm from FCA to PRA supervision (for example, how would the PRA obtain the necessary information to determine whether it considered that a firm had become suitable to be supervised by it and how would differences of opinion between the FCA and the PRA be dealt with?). Instead, we would favour a quantitative rather than a qualitative test that would eliminate the need for discretion to be exercised.

We consider that certainty of approach is the most critical issue for firms which have permission to deal as principal. We therefore prefer a clear and objectively certain test, and this test does not need to bear close relation to whatever ends up as being the internationally agreed test for identifying SIFIs.

In relation to the proposed threshold for investment firms being eligible for supervision by the PRA, we suggest that a "full scope BIPRU investment firm" would be a more appropriate category than a "BIPRU 730k firm" as being one of the conditions for a firm to fall under the PRA, thereby excluding, for example, limited activity firms. In addition we think there should be a balance sheet test to set an appropriately high threshold. We think the benefits of certainty outweigh the risk that a few firms may become subject to the PRA who arguably are not systemically important.

We think that the test should be clear and objective, and that the PRA should be required to supervise firms which meet the conditions, otherwise the certainty of an objective test is undermined.

It will also be necessary to avoid changes of regulator as balance sheets expand or contract. We suggest using an approach similar to that in the Conglomerates Directive so that for example, a firm which crosses the threshold will be treated as continuing to do so for a period of no less that 1/2/3 years

regardless of whether in fact it crosses back during that period. Such an approach provides the firm and the PRA with certainty.

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

Although we support the principle of the PRA taking a judgment-led approach, we have a number of concerns about some of the mechanisms proposed to achieve this. In particular:

- use of principles rather than rules: the use of principles rather than rules, the purposive application of those principles and requiring compliance with the spirit rather than the letter all come with the cost of reducing the certainty available to authorised firms as to whether or not their actions are compliant. We appreciate the desire to avoid a "tick box" approach to regulation and for the authority to maintain sufficient flexibility to exercise its judgment where appropriate, but a regulatory system that is fit for purpose and reflects best practice needs to provide authorised firms with a clear view of the standards expected of them and provide for firms to be treated with due process. We consider that this requires an underlying body of rules which are coherent and susceptible to interpretation according to a well understood body of precedent or guidance.

  Moreover, we question how this approach will operate in an environment where most rulemaking is carried out at an EU level and increasingly by way of Regulation rather than Directive. Although we agree with the proposal for statements of purpose to be included with rules that are made by the PRA, we question the extent to which it will be possible within the framework of EU legislation in relation to rules that implement Directive/Regulation provisions.

- more limited grounds for appeal: we are very concerned by the proposal to limit the grounds for appeal against supervisory decisions. The process of making supervisory decisions should be regarded as a quasi-judicial rather than an administrative process. The decisions taken may have major implications for firms and individuals. Individuals who are refused approval will always have to declare this fact on other applications, even though in many cases the reasons will not be to do with issues of integrity or reputation. Thus the exercise of the authority's decisions is capable of having fundamental effects on firms and individuals, such as their ability to

carry on particular types of business (in relation to decisions on authorisation and variation of permission) or to be employed in the financial services industry (in relation to approval of individuals to perform controlled functions). A judgment-led approach in relation to matters of this type should not imply that the authority can exercise discretions subjectively, without regard to the underlying principles and objectives of the rules that are being applied. The authority's exercise of judgment should accordingly be subject to appropriate checks and balances. Is not right to give the PRA greater discretions and then take away recourse. Such a framework is not justified , we do not see judicial review as a real option and the very existence of a framework under which decisions can be reviewed imposes a valuable and necessary discipline on those taking the decisions. We regard the existing framework under FSMA, which provides for a reference to the Tribunal, as an appropriate safeguard which has the advantage of being backed by an existing body of learning and practice. We do not think that restricting a right of appeal to a judicial review –style process would provide a meaningful safeguard, given the very limited grounds on which a challenge can be made. We would also question the compatibility of a general restriction of this type with the European Convention of Human Rights. At the least, we would urge the Government to consider distinguishing between those types of decision that would remain subject to the current right of referral to the Tribunal (in particular, decisions relating to the approval of individuals to perform controlled functions and decisions relating to the authorisation of firms and the scope of their Part IV permissions) and other supervisory decisions that would be subject to a more limited right of appeal.

- the PIF: The purpose behind the proposed Proactive Intervention Framework is only briefly alluded to in the paper, but it seems to be intended as a precursor to the resolution of a failing institution. There is stated to be a presumption that, once a firm is placed within the PIF, some form of regulatory action will be taken. Given the apparently severe consequences of falling within the PIF, we consider it important that appropriate safeguards are placed around the trigger for a firm to be placed within it, both in terms of defining sufficiently tightly in legislation or rules the circumstances in which this can happen and in terms of the process by which the trigger can be exercised by the PRA. Furthermore, thought should be given to measures to ensure that the fact that a firm has been placed within the PIF does not become public (for example, by making appropriate amendments to the Disclosure and Transparency Rules and by overriding

contractual disclosure obligations), since this may lead to a loss of confidence in the firm.

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

We suggest that more attention should be paid to the management of conflicts between the PRA and the Bank and its Financial Policy Committee – for example, in the situation where the PRA is considering whether or not to comply with a recommendation made by the FPC.

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

We do not consider that these proposals raise specifically legal issues.

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

We agree with the Government's proposals that there should be no significant reductions to the existing requirements to consult set out in FSMA. Nevertheless, we have some concerns as to what is implied by the use of the word "significant". We also question the formulation of the exception to the PRA's obligation to publicly consult as being "where to do so would be prejudicial to its objectives". We would prefer a more focused and limited exception, referring specifically to the need for urgency. If there is sufficient time to consult, we find it hard to see a justification for not consulting based on the authority's objectives since one of the key purposes of consultation, as the paper itself points out, is to ensure that a proposed regulatory intervention is indeed justified by reference to the authority's objectives and the principles.

In the context of an approach under which the PRA will make greater use of principles, we would also flag the importance of consulting on principles and any associated guidance issued by the PRA as well as on rules made by it.

The paper states that the Government will give further consideration to the question of whether the requirement to consult could be streamlined when implementing EU rules. In our view, the Government should be cautious in diluting the consultation principle in such cases. Even when implementing rules made in primary or secondary EU legislation, there remain important functions to be carried out at national level as to the method of implementation (copy out or something further), the consequential effect of new rules on existing legislation and regulation and the provision of guidance. Consultation on these

matters is likely to improve the quality of decision making , reduce the likelihood of inadvertent and unintended consequences and improve firms' understanding of the context and implications of the new rules.

In relation to the proposals to clarify how proportionality will be applied in relation to the cost-benefit analysis of proposed new rules, we would point out that, even in cases where it is not possible to monetise or quantify costs and benefits, it will still be appropriate to identify clearly the failure that any new rules are designed to address and the likely effectiveness of the rules in curing that failure in order to justify a regulatory intervention.

We also agree that the PRA should be under a duty to make and maintain arrangements for consulting practitioners on its policies and practices.

4. FINANCIAL CONDUCT AUTHORITY

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

As noted above, we support the formulation of clear statutory objectives. We suggest that paragraph 1 Box 4.A be amended to read:

"In discharging its functions the FCA must, so far as is reasonably possible, act in a way which:

(a) is compatible with its strategic objective, and

(b) advances one or more of its operational objectives."

Presumably the operational objectives are not expected to be exclusive.

We support the broad definitions of 'services' and 'consumers'.

With respect to the regulatory principles to which the FCA (and the PRA) must have regard, as noted above clarification is sought as to why Principle 3 is phrased as "the general principle". If this principle is in some way different to the other principles, it would be beneficial if this could be spelt out. If it is on the same footing as the other principles, we consider it desirable to delete the word "general".

As noted above we do not consider that Principle 5 is appropriate as currently drafted.

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

We support the proposed arrangements for governance and accountability.

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

The FCA's proposed product intervention powers are broad ranging. We note the Government's recognition of the need to strike a balance between enabling the FCA to act quickly to protect consumers and provide appropriate certainty for firms. We agree that the proposed product intervention powers will need to be very clearly defined and circumscribed, and we support the notion that the principles be designed to give clarity and certainty to the industry with respect to the FCA's expectations in relation to product design and product governance. With respect to the concept of proportionality, we agree that such powers are likely to be inappropriate in relation to professional or wholesale customers. Whilst we reserve judgement on the specific powers until such time as the consultation on the set of principles which will govern the use such powers is published, we do have the following comments which we hope may inform the Government's thinking in advance of that consultation.

The definition of 'product' is critical and will require careful consideration as this will, presumably, underpin the product intervention regime. The triggers for intervention will also need to be clearly specified, as will the scope of any particular product banning order. For example, if the banned product is present or embedded within a different type of product (for example, within a UCITS Fund) what will the effect of the banning order be? Will the UCITS fund be banned entirely, or will the fund be prohibited from investing in the particular product? What if the product is embedded within another product that the fund invests in, such that the fund has an indirect exposure to the banned product? It is proposed that legislation be introduced to make provision for the unenforceability of contracts made in breach of product intervention rules. What is to be done in respect of products that are sold in advance of a banning order? Will firms be expected to make refunds to clients that have already invested in or bought such a product, and if so, will clients bear the risk and reward of any market movement during the time between acquisition of the product and its banishment, or will the client be refunded the amount of his original investment? How will TCF obligations be viewed where customers have invested in such products?

The characteristics of a particular product that are objectionable will need to be clearly identified, not least because various instruments can have very similar outcomes, even though structured quite differently.

We note the statement that the product-banning power does not represent a move towards product pre-approval. However, given the costs of product development, and the potential damage to regulatory and commercial reputation in the event of powers of intervention being utilised, we would expect firms to seek a dialogue with the FCA as products are developed or altered to comply with banning orders.

Question 14: The Government would welcome specific comments on:

(a) the proposed approach to the FCA using transparency and disclosure as a regulatory tool;

(b) the proposed new powers in relation to financial promotions;

(c) the proposed new powers in relation to warning notices.

These are the most controversial and objectionable elements of this chapter in the consultation paper. We support the proposal that the FCA be open in disclosing its views on market developments (e.g. trends in products or services) and what it observes by way of firm behaviour, both good and bad. However, we consider that this can be achieved without unduly prejudicing the reputation of regulated firms. We do not consider that enabling the regulator to communicate with consumers about the remedial action it is taking, in order to increase the visibility of the actions of the regulator, outweighs long standing legal principles, including the presumption of innocence and the right to have an opportunity to present one's case.

The consultation paper states that the Government will ensure that any new powers contain the necessary safeguards to ensure that an appropriate balance is struck between interests of consumers and regulated firms. If the Government proceeds with its proposal we strongly suggest that a further opportunity be given to comment on the proposed legislation. Contrary to the FCA's strategic objective of enhancing confidence in the UK financial system, inappropriate powers could in fact lead to a lack of confidence in the UK financial system if there is a rush to early and potentially prejudicial disclosures.

(b) The proposed new powers in relation to financial promotions

The proposals could result in significant reputational and commercial damage to firms for potentially relatively minor breaches. We do not agree that providing evidence of the action that the regulator is taking in relation to financial promotions is a sound basis for justifying the disclosure of specific information that is likely to be unduly prejudicial to a particular firm. If the objective in publishing the fact that the regulator has asked a firm to withdraw a misleading promotion is to increase confidence in the FCA's ability to protect consumers, increase regulatory accountability and engender better practice across the industry, FCA could, for example, publish periodic anonymous data detailing the number of promotions that have been referred, the number reviewed and that it has requested be withdrawn, possibly by reference to product types or sectors. It could also highlight good and bad practices.

The current proposals suggest that a firm will be named even if it does not contest the FCA decision, such that all requests to withdraw financial promotions will be published. If this is the case, it is likely to encourage firms to launch appeals in order to avoid negative publicity resulting in increased costs for the industry, and depletion of the resources of the FCA. There can be situations where a firm might disagree with the FSA but the firm is prepared to agree to a request to change or withdraw a promotion. The attitude might be very different if the firm were to face having its name published and be to the overall detriment of the supervisory relationship. We understand that there is a balance to be struck and would suggest that rather than publishing the name of all firms requested to withdraw financial promotions, only serial offenders are named and shamed.

(c) The proposed new powers in relation to warning notices

We strongly object to these proposals and urge the Government to reconsider its stance. We do not consider that giving a regulator the power to disclose the fact that a warning notice has been issued is justified on the basis that it highlights potential issues to consumers and signals to firms examples of behaviour that the regulator considers to be unacceptable.

A warning notice is a step in a process, warning notices are highly selective as to their content, omit relevant material which does not assist the case on which the FSA wishes to rely and are issued before the firm or individual has had access to the material which the FSA has in its possession or an opportunity to challenge what the notice says. If the regulator has a case then it will appear in due course and it is at that point that the world is aware of the conduct that has

been found to occur and the regulator's view of it. Not every warning notice results in a Decision Notice. If a warning notice is published and there is no subsequent Decision Notice there is no public disclosure of why serious allegations have not been sustained, leaving a stain on a firm's or an individual's reputation. This is a stark contrast to a criminal process (which we do not think is an appropriate analogy but is one we have heard advanced) in which prosecution evidence is tested in the public gaze. In addition, in our experience, even when a warning notice is followed by a Decision Notice, the content is often materially different.

Nor do we consider that increasing the visibility of the actions that the regulator is taking to protect consumers interests to be a sound basis for introducing such measures. Indeed if as can be the case it subsequently appears that there were serious mistakes in the warning notice, or the case does not proceed as the regulator's enforcement team would wish, there is a considerable downside for confidence in the regulator.

Notwithstanding the Government's acknowledgement of the dangers inherent in such a proposal, and the proposed safeguards, we strongly diasagree that this will ensure procedural fairness for affected firms and individuals. In light of the commercial and reputational damage likely to be caused by the publication of such notices, procedural fairness can best be ensured by retaining a right to be heard and make representations prior to any publication of a notice. We consider that the highly prejudicial impact to regulated firms and individuals far outweighs any benefit to consumers and the regulated community, if indeed there is any such benefit. In simple terms, a significant punishment will be meted out to an individual or to a firm prior to any form of judicial process. The regulator has many other tools available to meet the objectives of highlighting behaviour that the regulator finds unacceptable, for example, in publications like Market Watch, Dear CEO letters, speeches and use of intervention powers. As currently envisaged, the proposals could be construed as a breach of natural justice, given that affected firms and individuals will not have the opportunity to refer the proposed publication to a third party, nor have their representations in relation to such disclosure heard. Further, the proposals dangerously shift the burden of proof towards a guilty until proven innocent stance.

As with the proposed powers in relation to financial promotions, we suggest that many of the Government's objectives could be achieved by way of publication of anonymous data. In this way consumers can be made aware of potential issues, and signals can be sent to firms regarding the behaviours deemed to be

unacceptable. We urge extreme caution in taking steps that undermine important principles of judicial process.

As a general comment we see great value in the continuation of a body like the Regulatory Decisions Committee and we would be concerned if there were proposals that would materially alter its status or operating methods.

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

We support the concept of the FCA having a stronger role in competition than the FSA has had to date. We would welcome the opportunity to comment on the more detailed proposals to be published following BIS's review of concurrency.

Question 16: The Government would welcome specific comments on:

(a) the proposals for RIEs and Part XVIII of FSMA; and

(b) the proposals in relation to listing and primary market regulation.

These proposals for the most part seem sensible. However, we would not characterise the extension of the UKLA's powers to impose sanctions on sponsors for breach of UKLA rules and requirements as a minor technical improvement. Further information on the nature and extent of such powers is required before any further comment can be made.

5. REGULATORY PROCESS AND COORDINATION

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

5.1 General comments

We are broadly supportive of the proposed mechanisms and processes to support effective co-ordination between the PRA and the FCA. Effective coordination between the two authorities is clearly a fundamental concern for dual-regulated firms which, if not properly addressed, will create significant operational dysfunctionality in the day-to-day supervision of these firms. While the proposed statutory duty to co-ordinate, obligation to prepare a Memorandum of Understanding (MoU) and cross-membership of boards by the two Chief Executives, undeniably represent steps in the right direction, they provide only an outline framework on which fully fleshed out processes for

effective co-ordination will then need to be devised. As the Treasury recognises in paragraph 5.28 of the Consultation, it will be the detailed day-to-day arrangements worked out by the two authorities that will underpin the legislative framework and ultimately determine if effective co-ordination is delivered in practice.

In view of the perceived difficulties associated with the practical operation of the current Tripartite Arrangement, we think it is vitally important that HM Treasury, the FSA and the Bank give considerable thought to the way in which effective co-ordination between the PRA and the FCA will be achieved on a day-to-day basis and seek the views of market participants on the proposed day-to-day arrangements to achieve this outcome. Ultimately, this will require the right culture to be established within each authority from its inception by its Chief Executive and senior management, whose relationship with their immediate counterparts will obviously need to be close, particularly in areas involving high anticipated levels of potential overlap and co-working. Each Chief Executive should convey the paramount importance of a culture of co-operation between the two authorities, with significant emphasis on ensuring synergies at all levels of their respective organisations. Crucial in this regard will be the steps taken in the early days, particularly the arrangements being put in place to establish a shadow operation ahead of the formal establishment of the PRA and the FCA. It seems to us that the new arrangements will be doomed to failure if staff from the two authorities are unwilling or unable to work together because of operational failures within the PRA and the FCA.

We think it is important that there is proper public consultation in relation to the detailed practical arrangements relating to the proposed division of regulatory responsibilities between the PRA and the FCA. In this regard, we welcome the statement that the Bank and the FSA will publish papers providing further details of these arrangements. Full public consultation on these issues is crucial to ensuring market confidence in the new regulatory arrangements.

5.2 Statutory duty to co-ordinate

We agree that it is preferable for the PRA and FCA to have a statutory duty to coordinate, rather than a statutory requirement for each to "have regard to" the other's objectives (as proposed in the July 2010 consultation document). It is vital that there is absolute clarity with regard to each regulator's responsibilities as regards all of the regulatory powers and processes set out in the Financial Services and Markets Act 2000 (FSMA) and the rules included in the FSA Handbook of Rules and Guidance. For this reason, we think there is considerable merit in responsibility for all regulatory processes and decisions

relating to dual-regulated firms being clearly set out in primary legislation. Restricting the scope of primary legislation to particular processes and decisions (as suggested in paragraph 5.9 of the Consultation) heightens the risk of uncertainty for the PRA, the FCA and financial market participants and increases the risk of disagreement between both authorities.

We have the following specific comments regarding the proposed statutory duty to co-ordinate:

- We are unclear as to whether the use of the terms "materially impact" and "where necessary" in the first and second limbs is intended to denote a subjective or objective standard. It would be important for the PRA, the FCA and market participants to have greater clarity regarding the circumstances in which consultation would be expected between the two authorities in the ordinary course, it being a mistake to set the bar at which consultation is required at too high a level.

- It seems to us that there should be an express statutory requirement for each authority to use its best endeavours with due regard to urgency when discharging its duty to co-ordinate.

- We strongly support the proposal that the third limb should require each authority to ensure that processes involving both authorities are managed congruently and efficiently. In particular, the PRA and the FCA should endeavour to exercise their powers on a joint basis in relation to the same dual-regulated firm in order to reduce regulatory burdens and potential regulatory arbitrage. We think there is a strong case for the statutory duty to co-ordinate to require each authority to manage the risk of a failure of effective co-ordination by ensuring that it has appropriate systems and controls to identify and remediate actual or potential breakdowns in co-ordination.

- We believe that the third limb should specifically require each authority to avoid duplication and otherwise reduce unnecessary burdens on dual-regulated firms. This outcome would clearly be highly beneficial for dual-regulated firms and would reduce the overall costs incurred by each authority in discharging its duties.

5.3 Memorandum of Understanding (MoU)

We are supportive of the proposal that primary legislation will require an MoU to be agreed between the PRA and FCA covering a non-exhaustive list of matters.

It is key that the MoU should be a full and detailed articulation of the framework for co-ordination and consultation between the PRA and the FCA.

We agree that the list of matters to be included in the MoU should be non-exhaustive on the basis that this will give the two authorities flexibility to include matters in the MoU that were not anticipated at the legislative stage, and to make amendments over time. We believe that the MoU should address the following matters not mentioned in paragraph 5.13 of the Consultation:

- Areas of common interest (in addition to how the roles of the PRA and the FCA are distinct).

- How the PRA and the FCA will avoid duplication in practice.

- How the PRA and the FCA will work together in relation to the proposed use of regulatory powers, changes in regulatory policy or guidance and regulatory decisions which are likely to impact the other authority.

- The circumstances in which information provided by dual-regulated firms to the PRA or the FCA will be shared with the other authority. In particular, dual-regulated firms will need to know the circumstances in which information provided to one authority will be treated as satisfying any obligation to provide the same information to the other authority. In this regard, we think it is important that both authorities accept the principle that notifications made by dual-regulated firms under the PRA and FCA equivalents of Principle 11 of the FSA's Principles for Businesses need only be made by the firm to the authority that it considers to be the most appropriate recipient in the circumstances.

- When and how the PRA and the FCA will carry out joint supervisory visits and inspections of dual-regulated firms.

- How the PRA and the FCA will consult to set regulatory fees and levies.

We agree that the MoU should be reviewed annually and are supportive of a requirement for the MoU to be laid before Parliament whenever changes are made on the grounds that this will provide a degree of external scrutiny. By way of additional external scrutiny, we think that each of the PRA and the FCA should be required to include a statement in its annual report setting out how the statutory duty to co-ordinate and related matters covered by the MoU have operated in practice over the relevant time period.

5.4 Cross membership of boards

We are supportive of the proposal that the Chief Executive of each of the PRA and the FCA should sit on the board of the other authority. We believe that it would be appropriate to restrict the Chief Executive of the FCA from voting on firm-specific decisions made by the PRA (and vice versa).

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

We understand that the proposed power of veto in favour of the PRA is intended to be limited in nature. That said, the existence of this power would appear to orient the balance of power between the two authorities in favour of the PRA and thereby play to perceptions that the PRA will in practice operate as the senior regulator. Indeed it seems to us that inappropriate or heavy handed exercise of the power of veto by the PRA will be likely to sully relations with the FCA, heightening concerns regarding future disagreements and failures to ensure effective co-ordination.

As a result, it is important that there is a greater degree of clarity regarding the limited circumstances in which the power of veto is likely to be exercisable by the PRA in practice. This will ensure that there is less scope for disagreement between the PRA and the FCA and will provide market participants with a clearer picture of the circumstances in which the power of veto could be exercised in practice.

Where a situation arises in which the FCA's actions may lead to the disorderly failure of a firm or wider financial instability, it would clearly be preferable for the PRA to discuss its concerns and endeavour to reach a solution with the FCA, consistent with the first limb of the proposed statutory duty to co-ordinate.

We agree that there should be an appropriate degree of transparency around use of the power of veto. We are supportive of the proposed legislative safeguards, although we are not clear if the proposed laying of the notification of the veto before Parliament is intended to take place before or after the power has been exercised (and would ask that this matter is clarified). Further clarity should be certainly provided in relation to the way in which considerations of public interest could affect the normal process of notification of the veto before Parliament.

We will provide more detailed comments on the proposed power of veto once the draft legislation is available for comment.

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

5.5 General comments

We agree that it is important to ensure that the authorisation process is both practical and efficient for applicant firms, and should not present inappropriate disincentives for firms wishing to enter the financial sector. As noted above it is also important for the competitive position of the U.K. Whilst this should be an objective for all firms, it is especially important to consider how this objective can be achieved for dual-regulated firms for whom there are likely to be considerable challenges in this area. As such, it is particularly important that the PRA and FCA co-ordinate effectively on matters relating to the authorisation process to minimise the potential pitfalls for dual-regulated firms.

Before commenting on the specific proposals outlined in the Consultation, we wish to point out the desirability of a potential approach not mentioned in the Consultation involving the use of a shared services function to provide a common back office for both the PRA and the FCA and a single application process for authorisations and approvals required for dual-regulated firms. If implemented correctly, this would address the concerns of market participants regarding the risk of duplication, would engender the co-operative working relations required to ensure the effective supervision of dual-regulated firms and would lead to a more efficient use of the resources of each authority. In light of this, we would strongly urge the Treasury to give serious consideration to the introduction of a shared services function for the PRA and the FCA.

Regardless of which model is adopted for the authorisation process, we consider it strongly desirable on the grounds of transparency for a single register of authorised firms and approved persons to be maintained for all firms along the lines of that currently operated today by the FSA. While a single register would naturally complement our suggestion that a shared services function be introduced for the PRA and the FCA, we see no reason in principle why it could not be introduced under each of the proposed models for the authorisation process suggested in the Consultation.

5.6 FCA regulated firms

We agree that the FCA should operate the authorisation process for those firms for which it is the sole regulator in much the same way as the existing Part IV process under FSMA.

5.7 Dual-regulated firms

In the case of dual-regulated firms, we note the Government's intention to give the authorities powers to designate sole or lead jurisdiction for one authority under each of the threshold conditions. We are concerned about the current lack of clarity regarding the arrangements for designating sole or lead jurisdiction under each of the threshold conditions. In particular, how will this designation take place and what will happen if the two authorities are unable to reach agreement? In practice, many of the threshold conditions are likely to be relevant to both authorities so it will be crucial for market participants to understand how these arrangements will work where one authority has been accorded lead jurisdiction in relation to a given threshold condition. We would urge the Treasury to provide further clarity as to the practical arrangements surrounding the threshold conditions for dual-regulated firms.

On the assumption that the Government decides to proceed with one of the two approaches to authorisation suggested in the Consultation, our strong preference would be for the alternative approach to be adopted in preference to the lead proposal. This reflects the fact that the alternative approach is likely to achieve a higher level of co-ordination and efficiency between the PRA and the FCA and will more closely replicate the existing 'one-stop shop' arrangements for obtaining authorisation from the FSA under Part IV of FSMA. It also reflects concerns about how the lead proposal would operate in practice, notably the inherent bureaucracy, inefficiencies and concerns about duplication that would be associated with a dual application process.

Our view is that the FCA should be responsible for processing all applications for dual-regulated firms under the alternative approach (on the basis that it would have to seek the consent of the PRA) rather than for this responsibility to be accorded to the regulator with prudential responsibility for the activity at the centre of the application. This approach acknowledges the fact that the FCA will in any event be responsible for processing the majority of authorisation applications relating to firms for which it is sole regulator. It also recognises the value of developing a centre of authorisation excellence within a single regulator and the potential difficulties that may arise in deciding whether some applicants would be prudentially regulated by the PRA or the FCA.

In view of the fact that the consent of both authorities will be required in order to progress an authorisation application under the alternative approach, particular attention should be paid to the co-operation that would need to take place between the PRA and the FCA in order to allow issues to be debated and resolved. A shared services function along the lines mentioned above would be particularly helpful in this regard and would seem to us to be a natural complement to the alternative approach. (We are assuming, as we hope is the case, that there will continue to be a single criminal law perimeter).

We think it would be highly undesirable for the alternative approach to become associated with a lack of transparency in relation to the application process, bearing in mind the inevitable background dialogue that would need to take place between the PRA and the FCA. In particular, any concerns of the authority which does not have responsibility for processing the authorisation application should be made known to the applicant. Likewise any reasons given for refusing an application or imposing limitations or conditions on an authorisation should be made clear to the applicant and be subject to a suitably transparent appeal process.

Whichever approach is adopted, firms must be given clear expectations of the time limits for processing authorisation applications and appropriate service standards should be applied. In particular, it is important that the time taken to review an authorisation application does not exceed the current statutory time limits and service standards applicable to the FSA under the current authorisation regime. In this regard, it would be extremely unfortunate from the point of view of the competitiveness of the UK as a place in which to establish a financial services business if the new authorisation process adopted for dual-regulated firms was significantly more time consuming, complex and costly than the equivalent authorisation process or processes applied by regulators in other EU member states. We suggest that consideration is given to imposing an automatic "approval" if an application has not been approved or formally entered the warning notice process within a prescribed time, at least for approved person applications , otherwise the statutory time limits are of little impact as they can be ignored by the regulator with impunity. In any event there must be published service standards and a means of holding to account for breach of them.

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

We note the Government's view that both regulatory authorities should be able to impose requirements that affect the nature of a firm's permission, in

accordance with their strategic and operational objectives. While we accept this basic premise, we think it is important that appropriate distinction is drawn between an Own Initiative Variation of Permission (OIVoP), a Voluntary Variation of Permission (VVoP) and a cancellation of permission.

As you aware we have expressed concerns before about the OIVoP regime. As the Government clearly intends to keep the regime we agree in principle that the PRA and the FCA should each be able to exercise OIVoP powers similar to those currently exercisable by the FSA. In the case of dual-regulated firms, both authorities should be subject to a statutory duty to consult the other and reach agreement before any exercise of OIVoP powers. We think it is important that any exercise of OIVoP powers by either authority is subject to appropriate safeguards and controls, similar to those applicable to the FSA today under the existing FSMA regime.

We take the view that the procedures for VVoP and cancellation of existing PRA or FCA permissions should mirror the alternative approach and should involve the FCA processing the associated applications and obtaining, in the case of dual-regulated firms, the consent of the PRA to the proposed variation or cancellation.

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

We agree with the Government's proposal that the FCA should have full power to designate controlled functions for those firms for which it is sole regulator and to approve individuals to undertake those functions, in each case on a similar basis to the current approved persons regime under FSMA.

We are very concerned about the apparent lack of clarity regarding the Government's proposals for the approved persons regime for dual-regulated firms. These concerns relate to the overarching principle that lead responsibility for controlled functions should be split between the PRA and the FCA in line with their objectives.

The proposals for dual-regulated firms envisage that the PRA would lead on designation and approval of all controlled functions connected to the prudential soundness of a regulated firm on the assumption that it would consult the FCA where it has an interest but would have the final say on the approval decision. In practice, we imagine that many of the existing controlled functions will be relevant in one way or another to both the prudential soundness of a dual-regulated firm and its interface with customers. Either way, the expectation is

that dual-regulated firms should make applications to both the PRA and the FCA and that there would be considerable behind the scene discussions between the two authorities.

It seems to us that the approved persons regime for dual-regulated firms should be rationalised along the lines of our preferred approach to the alternative approach discussed above. Under this arrangement, all approved person applications would be submitted to the FCA for processing and the FCA would seek the PRA's consent in relation to the approval of any controlled function connected to the prudential soundness of the firm. This would seem to us to simplify what would otherwise be a potentially cumbersome and duplicative twin track application process.

For any such arrangement to work in practice, the PRA and the FCA would be required to reach agreement on how the approved persons regime should operate, including which of the current controlled functions concerned only the PRA, only the FCA or both. Of particular relevance here would be any arrangements for the interview of candidates for approval to perform significant influence functions, which are likely to concern both the PRA and the FCA and, where an interview is involved, should involve a single interview attended by representatives from both authorities.

It is vital that the timeframes for processing approved person applications should not increase in order to take into account the regulatory changes and that the PRA and the FCA should adhere to the same statutory time limits and service standards as the FSA.

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

We agree that the FCA should have responsibility for the passporting process and administrative oversight of firms which have established branches in the UK under the passport.

We have some concerns about the practicalities of how the passporting process will work for dual-regulated firms wishing to establish branches in other EEA Member States under the passport. The suggestion in the Consultation is that there will be a separation of responsibility for dual-regulated firms, with the PRA being responsible for issues relating to financial soundness and the FCA being responsible for all conduct issues. There is no discussion of how this separation of responsibility would operate in practice. However, our clear preference would be for all such passport notifications to be received by the

FCA on a centralised basis and for a single form of notification to be used. This assumes that the FCA would seek the PRA's input on issues relating to financial soundness.

Although paragraphs 5.50 to 5.53 of the Consultation do not make this clear, we assume that the FCA will be responsible for receiving passport notifications relating to the outbound provision of services on a cross-border basis by UK authorised firms and the inbound provision of services on a cross-border basis by EEA authorised firms.

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

We imagine that mutual organisations will be concerned that the Government has dropped the requirement for the authorities to have regard to the need for diversity in providers of financial services. We take the view that the proposal that the PRA and the FCA must carry out a cost-benefit analysis of how consultation proposals will affect mutually-owned institutions is a poor substitute for a "have regards" requirement enshrined in legislation. It also falls short of the Government's commitments in the Coalition Agreement to foster diversity in financial services and promote the role of mutuals.

Whilst mutual organisations may take some comfort from the fact that the FCA does at least have the promotion of competition in its objectives, the PRA does not.

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

5.8 Rule making

We agree that the PRA and the FCA should have a statutory power to make rules that apply to regulated firms within their jurisdiction. However, in relation to dual-regulated firms, we are very concerned about the potential implications of the division of the current integrated FSA Handbook of Rules and Guidance into rules that are PRA specific, FCA specific or common to both. In practice, we imagine that there will be many instances where the PRA and the FCA would wish to adopt the same FSA rules as part of their initial rulebooks, with FSA rules relating to systems and controls and the FSA's Principles for Businesses being obvious examples.

In light of this, we think that there is a strong case for the PRA and the FCA to make joint rules in the areas in which they would both wish to exercise their

rule-making powers. Failing this, each authority should establish its own rules committee whose membership would include representatives from the other authority so that matters relating to common rules could be properly debated. Either arrangement would need to be underpinned by detailed co-ordination regarding the practical day-to-day application of any joint or common rules to dual-regulated firms, bearing in mind the crucial importance of avoiding unnecessary duplication and resolving any potential conflicts that may arise. This arrangement would inevitably have to recognise that each authority would wish to apply these rules in a manner that reflected its own specific objectives and its particular areas of expertise.

Of particular relevance are the FSA's current prudential rules set out in its GENPRU and BIPRU sourcebooks, which represent the UK implementation of EU prudential requirements. Both the PRA and the FCA will have significant responsibilities as prudential regulators and will be applying the same or similar prudential requirements to the firms they regulate. It is therefore important that both authorities recognise the need for consistent interpretation of these common prudential requirements and can justify any differences in their practical application on the basis of the differing business activities carried on by the firms that they regulate from a prudential perspective. Going forward, similar concerns would apply to other EU requirements implemented by the PRA and the FCA through joint or common rules.

While we welcome the suggestion that the FPC should play a role in resolving any conflicts that emerge between the PRA and the FCA, we note that its role would be limited only to disagreements relating to the authorities' assessment of the impact of a rule on financial stability. This does raise the important question of how conflicts would be resolved in relation to other types of disagreement between the PRA and the FCA. We would regard a process to resolve these types of disagreement as an indispensible component of the new regulatory regime and would urge the Treasury to give serious thought to the inclusion of a suitable process in the new legislation.

The duty of the PRA and the FCA to consult the other prior to making rules applying to the same functions within individual dual-regulated firms should also apply to any guidance (whether formal or informal) or statements of purpose (in the case of the PRA) relating to these rules. This reflects the paramount importance of avoiding situations in which conflicting messages are given to dual-regulated firms in relation to the application of the same or similar regulatory requirements.

5.9 Rule waivers

We agree that each authority should be able to consent to the modification or disapplication of the rules that it makes and that, in the case of a dual-regulated firm, the authority wishing to issue a consent should consult the other before issuing a direction approving an amendment or modification.

We note that, in the case of firms which are prudentially regulated by the FCA, the FCA would be required to consult the PRA if it considers that the proposed action could threaten financial stability, with the PRA being able to exercise its right of veto on these grounds. We think it would be a mistake to perceive the FCA as the "junior" partner in prudential regulatory matters in the case of these firms. In practice, the FCA will develop a considerable body of prudential regulatory expertise in relation to a broad range of financial sector firms, including some firms of significant size who, by virtue of their business activities, would never fall to be prudentially regulated by the PRA. In view of the PRA's focus on dual-regulated firms undertaking particular types of business activity, we think it is only right and proper that the PRA should pay close attention to the views of the FCA regarding the prudential regulation of other types of firm.

Question 25: The Government welcomes specific comments on:

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

5.10 Group supervision

We agree with the basic premise that, where 'solo' prudential supervision of firms within the consolidation group is split across the PRA and the FCA, the authority responsible for consolidated supervision should have a power of direction over the other authority. However, exercise of the power of direction should be a last resort option, bearing in mind the desirability of the two authorities being able to achieve a workable approach to consolidated supervision through prior consultation. In this regard, we agree that an authority should be under a duty to consult with its counterpart before a direction can be issued. We also agree that the power should only be available where a consolidation group exists under EU law and that it should be exercisable only where necessary to ensure effective consolidated supervision.

It is unclear from the Consultation if affected firms would receive early warning of the potential issue of a direction by the PRA or the FCA. We do think it is highly desirable for there to be a level of transparency to affected firms before the point at which they receive a copy of a direction.

It is important that the Treasury recognises that there will be circumstances in which firms will have a legitimate interest in ensuring that public disclosure of a direction does not take place. We therefore look forward with interest to receiving further details of the circumstances in which disclosure would be capable of being withheld in the public interest and the related procedures.

We note the contents of paragraph 5.72 of the Consultation, specifically the comment that the new authorities will be able to exercise discretion to carry out consolidated supervision with reference to the wider group so that the latter is effectively subsumed into supervision of the group as a whole. The exercise of this discretion should take into account any power of direction that an authority may have over unregulated holding companies and should be carefully exercised in practice. We would be very concerned if in practice this were to produce a different outcome for firms than that which arises today.

We are unclear how the proposed UK specific arrangements are intended to relate to arrangements with regulators in other EU member states regarding consolidated supervision issues and would ask the Treasury to give further thought to this issue.

5.11 Unregulated holding companies

We have some concerns regarding the proposed power of direction over unregulated parent undertakings which control and exert influence over authorised firms. Our main concern is the apparently low threshold at which the power becomes exercisable, namely where the authority considers it desirable for the purposes of fulfilling its statutory objective. We think that the exercise of this power should be an exceptional event and that this should be reflected in the conditions under which it is exercisable in practice. In this regard, we do think it is important that the power is exercisable only where all other available regulatory tools have been exhausted in relation to the relevant authorised firms.

Whilst we welcome the proposal to give a notice warning of the potential application of a power of direction, the devil will very much be in the detail of the process and the remedies that may be available. We are unclear why an

unregulated person should only have a right of appeal to the Upper Tribunal rather than a right to a de novo hearing.

We would ask the Treasury to confirm if the PRA's power of veto would apply to circumstances in which the PRA or the FCA is required to consult with its counterpart prior to issuing a direction affecting a dual-regulated firm or a group which includes such a firm.

We welcome the proposed publication of a statement of practice outlining how the power of direction will be exercised and look forward to responding to the consultation on the further details of the proposed power and the related safeguards.

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

5.12 Change of control

It is highly desirable for all change of control applications to be submitted to a single regulator. We are therefore concerned that the effect of paragraph 5.80 of the Consultation would be to require applications to be submitted to each of the FCA and the PRA in the case of a proposed change of control involving a group that included dual-regulated firms and firms which are prudentially regulated on a solo basis by the FCA. We think that this approach would be duplicative and cumbersome for market participants.

Consistent with our earlier comments, we feel that the FCA should be responsible for the receipt and processing of all change of control applications. This is on the assumption that the FCA would be under a statutory duty to consult the PRA in the case of dual-regulated firms. Adopting this approach would simplify the process for applicants and facilitate the use of a single application form for all approvals. It would also complement what we assume would be the lead role given to the FCA in bringing civil and criminal enforcement proceedings in relation to alleged breaches of the change of control regime.

In the case of dual-regulated firms, it seems to us that the rather complicated mixture of circumstances in which the PRA's views would take precedence over those of the FCA (or vice versa) has clear potential to create tension between the two authorities. This risk re-emphasises the great importance of effective co-ordination between the two authorities.

5.13 Part VII transfers

We agree with the comment that the current arrangements for transfers of insurance and banking business under Part VII of FSMA "work well" insofar as it relates to the Part VII mechanism of transferring business under a court-approved scheme. Our principal concern is therefore to ensure that the proposed regulatory reforms do not have a detrimental impact on the operation of the Part VII transfer mechanism.

The Consultation proposes that the PRA should take the lead on all Part VII applications. Whilst it is difficult to set any rules about which of the FCA and PRA will be most interested in a particular transfer, the FCA could perhaps be expected to have the greater interest on life transfers, with the PRA more in the lead on general/reinsurance transfers. We doubt the sense of the PRA leading on a Part VII transfer of life business, especially one involving with-profits business, where matters relating to Treating Customers Fairly are key, including in communications to policyholders. The key thing for insurers is that the Part VII mechanism should be clear and should not introduce yet more delay for clients. It would certainly be preferable to have a single process (albeit involving consultation between the two authorities) rather than two parallel processes.

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

While this question is primarily of concern to industry, we are supportive of the proposal to collect fees for both the PRA and the FCA through one organisation under a non-statutory arrangement.

We agree with the Treasury that it will be essential for the PRA and the FCA to use their resources efficiently in order to control their costs. This is inevitably one of the driving factors underlying the need for effective co-ordination between the two authorities. In particular, we believe that an approach involving a single application for authorisations and approvals being submitted to the FCA in the case of dual-regulated firms would be likely to involve significant cost savings.

6. COMPENSATION, DISPUTE RESOLUTION AND FINANCIAL EDUCATION

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

As we mentioned in our response to the August 2010 HM Treasury consultation paper on Financial Regulation, we consider that engaging in a micro-debate on the mechanics of operating and co-ordinating supervision of the Financial Services Compensation Scheme ("**FSCS**") at a time when European dispositions may be imminent and major policy decisions have yet to be taken is to risk creating a square peg for a round hole.

Nonetheless, it now appears that decisions will need to be taken about FSCS governance before the fundamental policy issues are resolved. We therefore look at (i) the role of the FSCS and the effectiveness of its pre-crisis operating model, coordination and governance, (ii) the lessons to be learnt from the recent crisis and (iii) the ways in which the FSCS may need to develop; (iv) we then set out our conclusions on the consultation questions above. These conclusions relate to the new legislation to be introduced very shortly and it may be difficult, at this stage, to anticipate and provide for the different ways that the FSCS functions may develop in the future. It may therefore be necessary to revisit these issues once the EU requirements/schemes are settled and conclusions have been reached on domestic policy for the FSCS schemes or their replacement.

(i) The role of the FSCS and the effectiveness of its pre-crisis operating model, coordination and governance

The FSCS obviously has an important systemic role as one of the safeguards which contribute to confidence in the financial system. For example, it was intended to increase depositor confidence and act as a break against a run on an individual deposit taker or a broader run on a group/herd of stressed banks or building societies. None of the authorities, however, (individually, or collectively as the tripartite,) made a realistic assessment of how the FSCS would meet this financial stability objective. In an echo of the broader position in relation to prudential regulation, that has prompted the coalition government's new approach to regulation, there was no realistic stress testing of the FSCS.

It was clear even in the early stages of the crisis that the FSCS deposit insurance protection was flawed, in systemic terms, (despite the fact that FSA had very recently consulted on and redesigned the FSCS (including the introduction of a new single scheme)). These flaws included – the uninsured share (90:10), the extent of coverage, the insured capacity compared to the size of the insured deposits, and the financial strength of the scheme (compared to its capacity/potential liabilities).

In addition there was a lack of clarity (and, therefore, lack of understanding) about the position of insured depositors. Most fundamentally, this uncertainty related to the position of the government/state (in another echo of the broader prudential position); depositors were uncertain whether the FSCS capacity was state guaranteed and whether, when aggregate claims exceeded that capacity, the government would step in to ensure insured depositors claims were met. There were many further areas of uncertainty – e.g. the position of depositors who also had client money on deposit at the same bank as a direct deposit. Other events, including the large levy on firms for the Keydata failure, have revealed many difficulties with interpreting and applying the FSCS current rules.

(ii) The lessons to be learnt from the recent crisis are

- There is a substantial macro-prudential/financial stability dimension to the FSCS role.

- The precedent of leaving FSCS design solely to the front-line micro-prudential regulator(s) (which the government appears to envisage following) is not a good one.

(iii) The ways in which the FSCS may need to develop

The crisis has prompted a wide ranging debate about FSCS type schemes. Although changes have already been introduced in the UK, for example to facilitate fast pay outs, it is difficult to predict today what the EU/UK schemes will look like in a few years time. There are substantive questions of macro-prudential policy still to be resolved and one can envisage from the current debate that there may well be major changes in the structure, scope and funding of the schemes and potentially fundamental changes in the institutions responsible for the new schemes. There are new bodies (FPC and ESRB) being established with a key policy role in this area and it may be some time before their views are known.

The single scheme established by FSA may well be broken up. It is possible that some elements could be replaced by an EU level scheme or arrangement. There may well be pre-funded schemes. The pre-funded Federal Deposit Insurance Corporation (FDIC) in the US is a very different animal to the current FSCS. It is an insurer with substantial premium income and with substantial financial resources; no doubt it has governance arrangements that reflect this. It is therefore very difficult, and probably impossible, to construct an 'operating model, coordination arrangements and governance' to fit all the different

outcomes in the UK (which necessarily depend on the arrangements and requirements at the EU level).

(iv) Conclusions

We suggest that the proposed operating model, coordination arrangements and governance for the FSCS (as set out in the current consultation) do not take sufficient account of

- the macro-prudential role of the FSCS function.

- the lessons to be leant from the recent crisis where the precedent of leaving FSCS design solely to the front-line micro-prudential regulator(s) did not work well and led to the failure to reach a balanced and realistic view on the role of the FSCS at a systemic level and in the context of the financial stability objective.

- the ways in which the FSCS (or parts of it) may need to develop in accordance with domestic policy or to meet EU requirements.

Our recommendations -

- As the body responsible for macro-prudential regulation, the FPC should have a recognised role in relation to (if not outright responsibility for) the overall design of FSCS type protection/funding (or at least for the systemically significant schemes (such as depositor protection) which emerge from the current single scheme). The design necessarily involves other macro-prudential issues/measures such as resolution arrangements and RRPs, capital and bail-ins etc ; it is paramount that a proper balance is struck and the FPC seems best placed to evaluate these issues and report on them.

- We doubt whether this macro-prudential role of the FPC can be achieved simply by the general power it will have to give directions to the micro-prudential regulator(s) - PRA (and FCA).

- The FPC could also deal with the issue of the state's role as a potential last resort provider of emergency protection/liquidity (a role that the UK government had to take on during the crisis – as FSCS funder/guarantor and in providing protection beyond FSCS limits), just as it will presumably look at the Bank of England's/the state's role (however limited) as the last resort provider of emergency liquidity and capital to the banking sector itself.

- We believe that it is vitally important that a proper balance is struck when setting the capacity, funding and scope of FSCS type schemes between the macro-prudential and financial stability objectives on the one hand and, on the other hand, the costs to firms (and therefore to consumers) of funding this insurance and their contingent liability to levies. The scheme design must be addressed according to a balanced objective. We believe this balanced objective should be recognised in the new arrangements and that all proposals for change should be subject to full consultation and cost benefit analysis in this context.

- Once the design, structure, capacity and funding of the scheme(s) has been determined, the operation will be a matter for the FSCS and the micro-prudential regulators. In that context we support statutory duties on PRA and FCA to co-ordinate in these matters as well as the publication of MOUs both between PRA and FCA and between FSCS and the two regulators.

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

We support the view that the Financial Ombudsman Scheme ("**FOS**") should remain an alternative dispute resolution service. We also agree that the role of FOS is to provide access to swift and impartial resolution of disputes between firms and customers, free to consumers to use, as an alternative to the courts.

However, we believe that the consultation paper misses a key point with regard to FOS. Whilst we shall comment on transparency below, this is not the main issue requiring clarification. Instead, the main issue is how FOS is going to function. There is a need for an overdue policy debate about the nature of the role of FOS.

'Swift and impartial' resolution of disputes cannot be allowed to mean decisions that are unpredictable and on occasion without any sound basis. The current role of FOS is to apply the law in relation to jurisdiction and to take account of the law in its decisions on merits and redress, within its fair and reasonable remit. We believe, though, that FOS has taken on the character of a secondary regulator in the retail /consumer world, making compensation awards in individual cases on the basis of a subjective view. These awards are then regarded as a form of precedent and can result in the requirement to provide compensation retrospectively across a significant part of the firm's business, even to customers who did not complain, because of a firm's wider obligations and TCF obligations. This in effect can impose an unpredictable backdating of

applicable standards, or impose new standards, on the financial services provider.

We consider that FOS should be obliged to apply the law in all instances, be constrained to take decisions in accordance with a clear set of rules, including those derived from European legislation. Financial services providers need to have certainty and the security of knowing that if they are compliant with applicable current rules and guidance and/or relevant legal principles, FOS will not have the discretion unreasonably to find against them. This is particularly important given that there is no appeals process from a FOS Final Decision; such a decision can have a substantial impact, including financial effect, on a firm and its business.

The consultation paper stresses the need to keep the roles of FOS and the FCA separate. However, joint operation could facilitate consistent application of the rules. Closer co-ordination is not currently working. There is no legal reason why FOS should not be part of FCA. Within this, FOS should focus on its function of dealing with individual disputes on a case by case basis, but under the oversight of FCA, whose role would be to ensure that the standards it applies are consistent with FCA's own published rules and standards. This would address the inconsistency, damaging for firms, of FOS decisions setting a precedent for FSA-regulated firms, while at the same time FSA says that FOS is operationally independent and not subject to its jurisdiction.

Addressing the specific question of transparency, whilst we note the Government's aim of clarifying the position with regard to the publication of decisions, we are uncertain as to the exact which makes it difficult to comment. For example, what is meant by publishing 'in a proactive and coordinated way'? It appears that the Government wishes to allow FOS to publish determinations 'if it considers it appropriate to do so'. In other words, FOS will be able to set the rules on this and decide if and when to apply them, with merely an 'expectation' that there will be some unspecified consultation on these principles.

We do not agree with the approach in this particular instance. We do not support publishing decisions on individual firms generated by complaints to which firms have no effective possibility of responding. We acknowledge the conclusions of the recent Hunt Review of FOS which focused particularly on transparency and accessibility, but do not understand why the Government would give FOS such wide discretion. The thrust of policy elsewhere within the financial services regulatory regime appears to be on imposition of rules by the regulator. Both complainants and financial services firms need to have just as

much predictability and transparency in the matter of publication of determinations as they do for the determinations themselves. We consider that it would be unacceptable to leave the choice of publication entirely to FOS, particularly given that the 'fair and reasonable' procedure applying to such decisions is wide and subjective. We propose instead that, in so far as the UK has freedom to set rules on this rather than being bound by EU legislation, the principles for publication of decisions are set by the FCA after the usual statutory consultation.

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

We support the requirement that publication of an annual plan by FSCS and FOS, as well as by the CFEB, be made a statutory duty, with associated consultation requirements. We also support the proposed responsibility of the National Audit Office for ensuring that these three bodies are carrying out their functions in an efficient and economic way.

The involvement of the National Audit Office must sit alongside the responsibilities of the FCA and/or PRA for ensuring compliance of these organisations, particularly FSCS and FOS, with the legal principles underpinning their functions.

7. EUROPEAN AND INTERNATIONAL ISSUES

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

We welcome the recognition by HMT of the need for effective engagement between the proposed UK regulatory authorities and the new European supervisory bodies and the need for co-ordination between the UK authorities in this context. In particular, we agree with the comments in paragraphs 7.13 and 7.14 about the importance of such co-ordination given the fact that the conduct of business/prudential divide cuts across the work of the ESAs. We refer to our comments on Chapter 5 in relation to the MoUs between the UK authorities.

We would welcome the establishment of a statutory MoU between the Treasury, Bank of England, PRA and FCA on overall international coordination within the UK system and would suggest that it may be appropriate for high level principles akin to those contained in Chapters 5.11 and 5.13 (Regulatory processes and coordination) to be contained in the MoU.

We would be delighted to discuss any of the above observations and suggestions with you. You may contact me on +44 (0)20 7295 3233 or by email at margaret.chamberlain@traverssmith.com.

Yours sincerely

Margaret Chamberlain

Margaret Chamberlain
Chair, CLLS Regulatory Law Committee

THE CITY OF LONDON LAW SOCIETY
REGULATORY LAW COMMITTEE

Individuals and firms represented on this Committee are as follows:

Margaret Chamberlain (Travers Smith LLP) (Chair)
Chris Bates (Clifford Chance LLP)
David Berman (Macfarlanes LLP)
Peter Bevan (Linklaters LLP)
Patrick Buckingham (Herbert Smith LLP)
John Crosthwait (Independent)
Richard Everett (Lawrence Graham LLP)
Robert Finney (Dewey & LeBoeuf LLP)
Jonathan Herbst (Norton Rose LLP)
Mark Kalderon (Freshfields Bruckhaus Deringer LLP)
Ben Kingsley (Slaughter and May)
Nicholas Kynoch (Mayer Brown International LLP)
Tamasin Little (S J Berwin LLP)
Simon Morris (CMS Cameron McKenna LLP)
Rob Moulton (Ashurst LLP)
Bob Penn (Allen & Overy LLP)
James Perry (Ashurst LLP)

CMS
Co-operative & Mutual Solutions Limited

CMS Limited's response to 'A new approach to financial regulation: building a stronger system' published 17 February 2011.

The response is from CMS and is in connection with the question posed in Section 5 of the consultation document covering the future location of the registration function for mutual societies, including Industrial and Provident Societies. The above question is being posed by Government in the light of the abolition of the Financial Services Authority (the FSA) the registrar for mutual societies since the demise of the Registry of Friendly Societies.

The relevant paragraphs are:-

'5.56 The Government is also considering the location and suitability of the functions and powers which are currently allocated to the FSA as registrar of mutual societies (including building societies, friendly societies, credit unions and industrial and provident societies). As a number of the powers currently allocated to the registrar are prudential in nature (for example, the ability to direct a transfer of engagements), it may be appropriate for these powers to be allocated to the prudential regulator rather than the registrar. Furthermore, it may be desirable to transfer responsibility for registration of industrial and provident societies outside of the financial regulatory perimeter. In particular, there may be a case for transferring registration of those societies which do not do financial services business, to avoid the misleading impression that these firms would be subject to conduct and prudential scrutiny on the same basis as firms conducting regulated activities. Options could include transferring these responsibilities to an alternative regulator or for the Government to work with the mutuals sector to establish a sector-led body which would be responsible for registration. The Government would welcome respondents' views on these issues, including respondents' views about other bodies – in the form of other regulators or alternatively sector-led entities – who could take on responsibilities for registration of non-financial mutuals.

5.57 In considering the appropriate location of the registrar functions for different types of mutual, the Government will have particular regard to minimising the burdens that may be placed on mutuals should it be appropriate to divide registration and regulation functions.'

CMS

Co-operative and Mutual Solutions Limited is a leading co-operative and social enterprise consultancy. Besides being a Society ourselves, many of our clients are Societies and the future location of their registrar is of great importance to them.

Background

Before answering the questions posed by the white paper it is important to understand the nature of mutual societies, especially industrial and provident societies. Mutual societies exist for the mutual benefit of their members, not to provide returns for outside investors. Whilst not all societies follow the seven principles of the International Co-operative Alliance they share certain key features: voluntary and open membership, democracy (one member, one vote), autonomy and concern for the community. Ultimately societies are ethical business and their regulation must regulate their ethics and the rules which enshrine those ethics if it is to regulate them at all. Finally, the vast majority of mutual businesses are not engaged in financial services and there is no compelling reason why mutual businesses should be regulated by a financial service regulator.

Companies House has historically had a policing role with regard to companies, ensuring that companies comply with the requirements for registration but with little concern for their internal governance, except where it is clearly illegal, or their activities. (This position has changed somewhat with the co-location of the Regulator of Community Interest Companies in Companies House). The regulatory function for mutual societies is more akin to that of the Charity Commission – a policing role, but also a role as the protector of the brand.

It is vital that the initial registration of societies and the continuing compliance with connected statutory requirements should involve the minimum complexity and expense consistent with carrying out the necessary role of Government and legislation identified below. The level of such costs must also avoid placing societies at a competitive disadvantage compared to companies. The legal structure must be easily accessible for business start-ups and must retain flexibility while empowering members as the business grows. In this function, the FSA has singularly failed – the costs of registration as a Society has consistently been much higher than for a company. Anecdotal evidence suggests that a significant part of this cost differential has been the need to recover the costs of an expensive location in Canary Wharf as opposed to Cardiff.

The registry should be act as a “filing cabinet” which is modern, efficient and makes the best use of technology. The current arrangements with the FSA have not delivered effectively on this role. Although the delivery has improved in recent years it still lags well behind the position for companies and charities to the disbenefit of mutual societies. It is possible for anyone wishing to do business with a Company to contact Companies House and receive electronically the documents they require within minutes; this is not possible for anyone wishing to do business with a Society.

In response to the question in Box 5.F

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

There needs to be a distinct regulator for mutual businesses. This regulator needs to offer:-

a) A registration and 'filing cabinet' service which provides a level playing field to that for companies in terms of fees and availability of documents to the public.
b) A regulator of the ethical intent of mutual societies both at their creation and in their ongoing business.
c) A protector of the 'brand' of mutuality to ensure that the brand reputation is maintained.

There are three broad options:-

a) A free standing regulator
b) Regulation within a financial services regulator
c) Co-location with another registrar

CMS's view on these three options is as follows:-

A Free Standing Regulator

This would be the ideal. However, we have serious doubts that it is sustainable. The largest class – Industrial and Provident Societies – has about 8 000 members and around 250 new registrations per year. The number of new Building Societies, Credit Unions and Friendly Societies registered each year is negligible. Our fear is that a free standing regulator would need to charge higher fees to cover its costs than the registration and filing fees for companies. Hence there would not be a level playing field between mutuals and companies.

Unless a business case can be made that the fees for a free standing regulator would be roughly equivalent to those for Companies House, CMS would not support this option.

Regulation Within A Financial Services Regulator

As the FSA has been regulator of mutual societies then the regulation of mutual societies could remain with a financial services regulator – the Bank of England itself, the Prudential Regulation Authority (PRA) or the Financial Conduct Authority (FCA).

However, the experience of regulation of mutual societies (except where mutual societies happen to be financial services businesses) by the FSA has not been a satisfactory one. There are three main reasons for this:-

a) The volume of work regulating the financial services industry dwarfs the volume of work providing a registry service to mutuals. Quite rightly, the primary focus of work by the FSA was on regulating financial services businesses. The 'filing cabinet' function enabling the public to check details of mutuals on-line fell well behind the equivalent functions in the Charity Commission and Companies House.
b) The culture of the FSA was overwhelmingly determined by its primary purpose of regulating financial services businesses. Again, this was quite right but meant that the FSA was not culturally attuned to mutuals based in, say, retail, energy production or manufacturing. There was no concerted attempt to promote or protect the mutual 'brand'.
c) It created confusion among potential new mutuals – they could see no logic to why their, say, retail mutual was to be regulated by the Financial Services Authority.

CMS would be worried these problems would be replicated if the registration function for mutuals was to be within a new financial services regulator. If this were to happen there would need to be a clear terms of reference for the regulator that their job included both delivering a level playing field with companies regarding the 'filing cabinet' function and a duty to pro-actively promote and protect the 'brand' of the mutual form.

Co-Location With Another Registrar

This means the creation of a distinct registration office within another registrar. The mutual societies registration service would have some distinct functions. Some functions may be shared and costs and overheads would be shared. This seems to be the most practical option. There are two potential registrars within which mutual societies registration would be co-located – the Charity Commission or Companies House.

The Charity Commission is a modern, efficient and effective regulator and registrar. Culturally it combines a registration function with a policing of the ethics of charities and a protection and promotion of the brand of charities. In many ways, this is the sort of registrar and regulator mutual societies require.

However, there are two concerns with the Charity Commission as registrar for mutual societies. The first is that the Commission provides a free service to charities. Unless it were also to offer a free service to mutual societies, it is unclear how a free and a charged service would work together. More fundamentally, there are major doubts that the Charity Commission could be a sympathetic registrar for mutual societies. Under the Charities Act 2006 regulation for exempt charities registered as Industrial and Provident Societies was meant to pass over to the Charity Commission. This has not happened. It appears that the Charity Commission has had fundamental difficulties with the governance of societies and, in particular, the fact that they are limited by shares. This does not bode well were the Charity Commission to become regulator for all mutual societies.

Companies House is a modern, efficient and effective regulator and registrar. Historically it has not combined a registration function with a policing of the ethics of companies and a protection and promotion of the brand. This was a major concern when the Registry of Friendly Societies was abolished and one of the reasons the registration function for mutual societies ended up at the FSA.

However, there have been two developments since then. At about the same time as the decision to abolish the Registry of Friendly Societies, Companies House took over the registration function for the newly created Limited Liability Partnerships. Whilst this still does not involve the policing of the ethics of LLPs and a protection and promotion of the brand, it has shown that Companies House can act as registrar for another legal form.

More importantly, Companies House has hosted the registration function for Community Interest Companies (CICs) since July 2005. Culturally the Regulator of Community Interest Companies combines a registration function with a policing of the ethics of CICs and a protection and promotion of the brand of CICs. The CIC Regulator has a separate office and small specialist team within Companies House. The CIC Regulator performs some distinct functions, some functions are shared with Companies House and costs and overheads are shared. Registration and filing fees for CICs are therefore broadly similar to those for other companies and information about CICs is as easily obtained as for any other company. Whilst there are occasional hiccups between Companies House and the CIC Regulator's office they are infrequent – CMS has only experienced two cases in nearly six years of operation.

The experience of the co-location of the CIC Regulators' office in Companies House suggests that Companies House could host a co-located Mutual Societies Regulator on a very similar basis.

Conclusion

CMS believes that, unless a clear business case can be set out for the financial viability of a free standing regulator charging similar levels of fees to Companies House, that the registration and regulatory function for mutual societies is best carried out by an independent Regulator of Mutual Societies office co-located within Companies House.

Response to HM Treasury consultation on a new approach to financial regulation

About Co-operatives UK

1. Co-operatives UK works to promote, develop and unite co-operative enterprises. It has a unique role as a trade association for co-operative enterprises and its campaigns for co-operation, such as Co-operatives Fortnight, bring together all those with a passion and interest in co-operative action.

The co-operative economy

2. There are already over 4,990 co-operatives in the UK, owned by more than 11 million people – and these numbers keep on growing.

3. Co-operatives are businesses that exist to serve their members, whether they are customers, employees or the local community. They work in all parts of the economy including retail, banking, food and farming, design and renewable energy. Co-operatives also deliver a range of public services including housing, social care, sport and leisure, recycling and healthcare.

4. Members are the owners, with an equal say in what the co-operative does. So, as well as getting the products and services they need, members help shape the decisions their co-operative makes.

5. Further information about Co-operatives UK and the co-operative sector can be found on our website www.uk.coop

Response

6. The HM Treasury consultation on a new approach to financial regulation poses questions as to the registration function of mutual societies. Co-operatives UK has particular interest in the registration of industrial and provident societies currently undertaken by the Financial Services Authority.

Role of the Registrar

7. The Registrar of industrial and provident societies (IPS) is quite distinctive. The Registrar is duty bound by the legislation to ensure societies registering under the Industrial and Provident Societies Act 1965 are doing so in accordance with the Act, in that they are either a bona fide co-operative or a society that is conducted for the benefit of the community. The Registrar does this by examining the rules of each society upon registration and when any

subsequent amendments are made. This distinction is fundamentally important to protect the integrity of the co-operative movement and society form.

8. Following the relocation of the function to the Financial Services Authority (FSA), Co-operatives UK has sought to engage with the Officers to encourage them to take their responsibilities appropriately. There has been a perceived lack of priority focused on this function within the FSA which has led to a diminished profile for IPSs. Cost has been an issue in line with the FSA policy of no cross subsidy between fee groups, however, the lack of proactive management to ensure periodic fees are collected has led to a valuable fee source being neglected and thus to under investment. Since the move from the Registrar of Friendly Societies, despite the best efforts of individual officers, there has been little evidence of advancement or improvement.

9. There are 8000 societies worth over 39 billion pounds to the UK economy. This unique form has suffered from a lack of engagement and investment from government for many years. IPS is the only form which enshrines democracy and engagement, exactly what the current government is wishing to pursue. It now has the opportunity to follow through with positive action by ensuring the new Registrar is fit for purpose.

10. We believe IPSs need a forwarding-looking Registrar who is proactive in providing and publishing advice and information, and encourages the development and profile of the brand, by setting standards and raising awareness. Appropriate investment will not only bring up the standards to a level similar to other forms, it will allow the development of this unique and distinctive form to address the needs of today's society. There is a developing and positive interest in the IPS form. Investment at this stage in a properly functioning registrar will would facilitate an increase in the size of the sector. For the government not to take this function seriously would demonstrate a real policy gap between the rhetoric of the big society and the reality.

11. There are in our view three options for the Registrar moving forward

    a) An independent outward focused dedicated Registrar.
    b) Continuation with the FSA under one of its own new forms.
    c) Re-location within an existing Registrar framework.

12. Whilst an independent dedicated Registrar would always be the ideal, it has to be recognised that without investment from government this would not become a reality and without this commitment and support this option could not seriously address the needs of the sector.

13. Co-operatives UK have consulted members on a number of possible options for the Registrar function. The favoured option is for Companies House, as the current Registrar of the other main type of corporate body, to be the location of the IPS Registrar function.

14. However, the registration of companies is focused on process rather than content, operating on the principle of self-declaration, in which the onus is on

the applicant to ensure that a Company's governing document is in accordance with the law. It is, therefore, entirely possible to register a company with a governing document that does not meet the requirements of the Companies Act 2006 or even make sense. The registration process is, however, efficient and inexpensive.

15. As mentioned, the procedure for registering a society currently requires the Registrar to check that the applicant meets the requirements in legislation. Given the existence of the CIC Regulator, it would seem reasonable that a similar function within Companies House could be created for a Society Registrar, who could continue to check rulebooks as required by IPS legislation in the same way that the CIC Regulator does for CICs, albeit noting that the IPS tests are – arguably – more stringent.

16. This option would have the advantage that societies could benefit from the higher levels of service that Companies House offers and the economies of scale and collective efficiencies of a large organisation, thereby reducing costs. A further advantage is that there would be a pool of specialist knowledge created by the provision of a tailored service. There are disadvantages with this option: there could be pressure to streamline systems and processes in line with the Companies House overall target of reducing costs, which could be to the detriment of the IPS form.

17. As part of the consultation of our members, we also identified a possible outcome, which our members deemed – without exception – to be unacceptable: the possibility that the government will decide that the function should be hived off to the highest bidder as a commercial exercise. There would be no guarantees that any body appointed to be in control of the registrar function would have the relevant knowledge of the co-operative sector. Further, a commercial focus could lead to a move towards processing and automation, which, whilst in some areas this may be welcome, could also mean cutting of corners when it comes to the preservation of the legislative ethos.

18. If the role of industrial and provident society Registrar is to remain with any successor body to the FSA, we will seek to ensure there is an improvement in the levels of service offered by the Registrar on behalf of the members of Co-operatives UK.

19. We understand from Treasury discussions that the intention from the current process is to ensure that the forthcoming bill contains enabling provisions in relation to the registration function, and that the current thinking would involve two options

    a) move to CIC regulator
    b) move to one of the newly formed parts of the FSA

20. Whilst the ultimate physical location of the registrar will lead to further discussion and consideration of what will, no doubt, be complex issues. At this stage of its consideration the role and function of the Registrar should be the priority. The consultation document in paragraph 5.55 refers to the

government's commitment to undertaking further analysis on proposed rules as to how they affect mutually-owned institutions, presumably with a view to ensuring all legal forms are treated appropriately. As the government has recognised the need to do this, it is clearly appropriate that such criteria is applied to the registration of the IPS form, which has to date not received the investment or commitment to ensure it is treated in a comparable way to other such forms.

21. Nevertheless it is important that the path to registration should be as efficient and easy as it is for other corporate forms, particularly companies. Likewise, the Registrar's role in providing information on societies should be on the same basis as for other such bodies e.g. accessible and searchable online.

22. The Government expects the current CIC Regulator to encourage the development of the CIC brand and provide guidance and assistance on matters relating to CICs. Accordingly, the body that held the registrar function for IP should equally encourage the development of the co-operative and community benefit brand and provide guidance. The lack of positive engagement from the current Registrar has been to the sector's detriment. The touch applied should be appropriate to requirements of the legislation.

23. There is a developing and positive interest in the IPS form, particularly in regard to community shares. Whilst this is a vibrant and creative initiative, matching perfectly with the government desire for community ownership and engagement, it has to be recognised that there are concerns that, as a result of the lack of investment in the IPS form, particularly so in relation to published policy guidance, that this could lead to misguided practices. Co-operatives UK manage several codes of practice for its members on governance and other matters such as use and promotion of withdrawable share capital. Further we have promoted proposals in relation to a form of co-regulation for those societies engaged in creating community wealth via direct community investment.

24. The co-operative sector has always been proactive when it comes to self-monitoring and compliance, engagement and values are a central point of its values and ethics. A Registrar that encourages and recognises the value in this behaviour and which proactively bought into working in partnership with the sectors would be not only be highly regarded but would fit with modern practices of openness and customer focused behaviour.

25. Equally, recognition across government as to the status and function would be important to ensure the form was taken into account and considered, particularly when new initiatives are being developed.

26. To ensure this profile, the name and status of the Registrar would be important. A title such as the Community Mutuals Registrar, the Societies Registrar, or Community Interest Registrar should be considered.

27. Should it be that the preferred move is to the CIC Regulator and given the

relative sizes of the sectors in that IP dwarf CIC[1], it would be entirely inappropriate to simply shoehorn one function into another. There would then need to be comprehensive reform of both functions to ensure a merger and equitable treatment.

28. As mentioned, we understand that the intention at this stage is to ensure the bill contains appropriate provisions to facilitate a change in Registrar location. We would argue it needs also to be able to facilitate a change in function, not only of the existing Registrar, but that of its potential new home, to ensure equitable and fair treatment, particularly so if this were to be the CIC registrar provisions to facilitate a change of name and function would, as mentioned, no doubt, require appropriate legislation.

Helen Barber
Secretary and Head of Legal Services,
Co-operatives UK
14th April 2011

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[1] At the time of writing there are 4976 CIC s and over 8000 IP societies, collective turnover of IPS is over 39 billion pounds, we have not been able to locate turnover data for CICs although anticipate given the relative age of the sector, this amount is considerably less.

Response April 2011

A New Approach to Financial Regulation: Building a Stronger System

CBI Response

Tristan Clarke | Head of Financial Services | CBI
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Further improvements are needed on the objectives, governance and operational mechanisms to achieve the twin objectives of regulatory certainty and flexibility to respond to changing business models and risks over time

The CBI represents firms from across the regulated financial sector and their customers.

Summary

We note the changes that have been made from the initial consultation and are pleased that they reflect and address many of the CBI's concerns.

On balance we support the proposals set out in the consultation paper and believe that much of this will allow the development of a robust and flexible regulatory framework. There are, however, a number of areas remaining where we believe that aspects of the proposed regulatory framework should be reconsidered.

We believe that changes to the regulatory objectives and principles are needed in order that the regulatory framework will drive the regulators to achieve the right outcomes, and there remain practical issues of coordination for the regulators and challenges in developing an effective operating model. Governance arrangements must also be put in place that reflect the regulatory objectives and the firms that the regulators oversee

We view many of the proposals that relate to the prudential and conduct of business regimes positively but have some reservations about how rules will be made and when the new tools will be used.

We set out our responses in this document under the following headings:

1. Regulatory objectives and principles
2. Coordination
3. Governance
4. The conduct regime
5. The prudential regime

These responses are linked to the specific consultation questions in Appendix A.

1. Regulatory objectives and principles

We broadly support the objectives that the FPC, PRA and FCA have been set in the consultation and the regulatory principles to which they must have regard. However, the regulatory objectives will guide the regulators and how they work together over the long term and it is essential that they are remain appropriate for the future, after the economy has recovered from the financial crisis.

FPC growth objective

The FPC objectives should have a proactive focus on supporting economic growth…

The FPC will have an operational objective, which requires it to promote the safety and soundness of the UK financial system but this is not balanced by any objective that requires it to consider the wider growth and condition of the economy.

We recognise that the FPC will not be 'authorised' to exercise its function in a way that would have a long term adverse effect on the economy and we note the assertion in the consultation that stability and growth are complementary, not contradictory.

However, while we agree that the two are not contradictory, neither will they always go hand in hand. The FPC's objective should require the Committee to be proactive in ensuring that its decisions are consistent with long term growth. The objective could, for example, be phrased as:

'*The responsibility of the Committee in relation to the achievement of that objective relates primarily to the identification of, monitoring of, and taking of action to remove or reduce, systemic risks with a view to protecting and enhancing the resilience of the UK financial system in a way which is consistent with promoting the medium and long term growth of the UK economy.*'

Competitiveness objective

Regulatory objectives that focus on stability and good conduct should be balanced by the objective of maintaining competitiveness…

We are disappointed that the objectives do not reflect the need to maintain the competitiveness of the UK and its financial sector. It is true that stability, fairness and a strong regulator are all features that are necessary for a financial sector which is globally competitive. However, it is also true that a regulator that does not need to consider the competitiveness of the market might produce regulation that enhances stability or promotes good conduct while also damaging the market's competitiveness.

The PRA and FCA should have an operational objective that requires them to 'maintain the international competitiveness of the UK' as operational objectives and the FPC should have this as a factor to which it should 'have regard'.

There is no reason that maintaining the UK's international competitiveness would override financial stability or conduct, indeed we are sceptical of claims that the FSA's existing international competitiveness factor in the Principles of Good Regulation contributed to regulatory failures in the past. The regulators should work at an international level to develop appropriate legislation and should have a presumption against gold plating.

Bank of England's financial stability objective	1 An objective of the Bank shall be to protect and enhance the stability of the financial system of the United Kingdom (the "Financial Stability Objective"). 2 In pursuing the Financial Stability Objective the Bank shall aim to work with other relevant bodies (including the Treasury, the Prudential Regulation Authority and the Financial Conduct Authority).
Financial Policy Committee	1 The Financial Policy Committee is to exercise its functions with a view to contributing to the achievement by the Bank of the Financial Stability Objective. 2 The responsibility of the Committee in relation to the achievement of that objective relates primarily to the identification of, monitoring of, and taking of action to remove or reduce, systemic risks with a view to protecting and enhancing the resilience of the UK financial system. 3 These systemic risks include, in particular – • systemic risks attributable to structural features of financial markets or to the distribution of risk within the financial sector, and • unsustainable levels of leverage, debt or credit growth. 4 This does not require or authorise the Committee to exercise its functions in a way that would in its opinion be likely to have a significant adverse effect on the capacity of the financial sector to contribute to the growth of the UK economy in the medium or long term. 5 "Systemic risk" means a risk to the stability of the UK financial system as a whole or to a significant part of that system.
Prudential Regulatory Authority	1 In discharging its functions the PRA must, so far as is reasonably possible, act in a way which • is compatible with its strategic objective, and • advances its operational objective. 2 The PRA's strategic objective is: • contributing to the promotion of the stability of the UK financial system. 3 The PRA's operational objective is: • promoting the safety and soundness of PRA authorised persons. 4 Promoting the safety and soundness of PRA authorised persons includes seeking, in relation to each PRA authorised person, to minimise any adverse effect that the failure of that person could be expected to have on the UK financial system.
Financial Conduct Authority	1 In discharging its functions the FCA must, so far as is reasonably possible, act in a way which • is compatible with its strategic objective, and • advances one of its operational objectives. 2 The FCA's strategic objective is: • protecting and enhancing confidence in the UK financial system 3 The FCA's operational objectives are: • facilitating efficiency and choice in the market for financial services • securing an appropriate degree of protection for consumers • protecting and enhancing the integrity of the UK financial system 4 The FCA must, so far as is compatible with its strategic and operational objectives, discharge its general functions in a way which promotes competition.

Table 1: The proposed objectives

The FCA and competition

Competition should be placed on an equal footing with the FCA's other operational objectives…

It is proposed that the FCA will be granted an objective which requires it, so far as is compatible with its strategic and operational objectives, to discharge its general functions in a way that promotes competition. It is further proposed that it will be granted a number of powers, including keeping financial services competition under review, make a Market Investigation Reference to the competition authorities or agreeing legally binding commitments with the industry rather than making a referral.

We support the elevation of competition from being a factor to which the FCA should 'have regard'. However, as recognised in the paper, competition can be used as an effective tool to improve consumer outcomes, particularly where issues arise across market sectors rather than at individual firms. The FCA should use competition and market driven approaches to resolve conduct of business issues in the first instance if this would be the most effective approach.

We would therefore support competition being placed on an equal footing with the other operational objectives.

The FCA should ensure that its work is coordinated with, but does not overlap, that of the proposed Competitive Markets Authority. The FCA's authority should be clearly carved out of the CMA's objectives and operational arrangements that describe the boundaries in practice should be described in an MoU.

Both the FCA and the PRA should be obliged to consider and respond to recommendations made by the competition authorities, recognising that there will be circumstances, particularly for reasons of financial stability, where the recommendations may not be implemented.

The FCA will need to set out how it plans to approach its competition role in practice. It will require competition skills and resources but these should complement its conduct of business role and must not replace, supersede or detract from it.

Regulatory principles

The regulatory principles should reflect the wider economy and supporting market competition…

The Consultation Paper proposes that the PRA and FCA will need to 'have regard' to a number of Regulatory Principles. The Regulatory Principles will not apply to the FPC but it will need to have regard to three other factors: Proportionality, openness and international law.

The PRA and FCA must have regard to:
• the need to use the resources of each regulator 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, considered in general terms, which are expected to result from the imposition of that burden or restriction; • the general principle that consumers should take responsibility for their decisions; • the responsibilities of the senior management of an authorised person in relation to compliance with requirements imposed by or under this Act; • the desirability in appropriate cases of each regulator making information relating to authorised persons or recognised investment exchanges available to the public, or requiring authorised persons to publish information, as a means of contributing to the advancement by each regulator of its strategic and operational objectives; and • the principle that the regulators should exercise their functions as transparently as possible.

Table 2: The regulatory principles

We support the purpose of the regulatory principles. There are, however, a number specific of enhancements that we believe could be made. The Principles should, more generally, be aligned with the Better Regulation Principles that any regulation should be:

- transparent
- accountable
- proportionate
- consistent
- targeted only where action is needed

Principle 2

We suggest that the Principle that relates to the cost and benefit of a 'burden or restriction' should explicitly consider not only the cost to the firm in question but the wider cost to the firm's customers, the market and the economy. The purpose of this would be to help balance the regulators' objectives and to ensure that they maintain a wider perspective when developing rules and undertaking day to day supervision.

Principles 5 and 6

We support the Principle that transparency of the regulators is an important part of their accountability, particularly to the firms they supervise. We also agree that in some limited cases publishing information can help customers and allow the regulators to achieve their objectives. However, stronger caveats should be placed on these principles to ensure that information is released only where a full regulatory process has been conducted and that due respect is paid to the need for confidentiality of personal and commercially sensitive information.

Competition Principle

We recommend that an additional principle should be added, mirroring the FCA's competition operational objective, that would require the regulators to consider when developing new rules whether there is a solution that uses competition mechanisms that could achieve the same objective.

Competitiveness Principles

We also believe that a principle should be added to encourage regulators to allow firms of different types to operate on a level playing field both within the UK and internationally, unless there is a good reason why this would not be appropriate or it conflicts with one of the main objectives.

The principle that should be introduced could be phrased as set out below so that the regulators have regard to:

'the need for competitive equivalence between firms within the UK market, and between firms operating in the UK market and other international markets.'

This is consistent with the objectives of other overseas regulatory bodies and would support the need for the regulator to consider the competitiveness of sectors within the UK market and of the UK's financial sector itself.

Sunset clauses and consultation

New rules should include sunset clauses and review periods…

Financial services regulation is by its nature complex and often has implications not just for the firms to which it directly relates but their customers and the wider economy. We believe that it is important that there is a framework around rule making powers that encourages a flexible and evidence based approach to rule making. We therefore suggest that the procedural requirements that the FCA and PRA will need to follow should be retained, including the need to consult on proposed rule and the need to prepare cost benefit analyses.

There should also be an automatic presumption that new rules should be subject to review after a given period of time. This would permit regulators and industry to review the effectiveness of rules and continue them or refine or remove them if appropriate.

There may be circumstances where the FPC wishes to use tools without the need for a full consultation and cost benefit analysis. Putting in place an assumption that sunset clauses would be used would be a valuable control over the process.

2. Coordination

We support the efforts made to encourage coordination between the two regulators but we believe that more must be done to manage the operational complexity in a number of areas.

General coordination

Coordination of the regulators will be a significant challenge and early consultation with the industry on operational proposals is essential…

The new regulatory regime will be more operationally complex than the FSA's structure. It is likely to face significant challenges coordinating its response to specific regulatory issues, its day to day supervision and its policy making both when it is first established and over the longer term.

We note and support the proposals to improve coordination between the two regulators (see box opposite) but recognise that day-to-day coordination between line supervisors and policy teams will need more detailed and practical coordination. This will be a significant challenge and we believe that it is important that the FSA engages with the industry early and comprehensively to discuss and gather views on the practical arrangements for the coordination, as well as their statutory basis.

The arrangements for coordinating the two regulators will need to be flexible and dynamic if they are to be successful. This will require the MoUs and operating arrangements to be reviewed and subject to open and pragmatic external debate and consultation periodically.

Effective coordination is particularly important in a crisis and a mechanism should be established to ensure that the right parties are brought to the table early in any emerging crisis situation.

The general duties of coordination include:
• a statutory duty to coordinate the exercise of their functions • an obligation to prepare a Memorandum of Understanding (MoU) • cross-membership of boards • specific mechanisms to reduce the risk of regulatory actions threatening financial stability or the disorderly failure of a firm

Table 3: Duties of coordination

A standing committee could be established which would be convened if one of the regulators or the FPC had identified a potential emerging systemic risk, or if there was any other significant event that might have a significant effect on financial markets or could be expected to be materially increase the risk of a systemic crisis emerging.

This would provide a mechanism around which the regulators could coordinate their actions and could provide a conduit through which HMT and the Government could be provided with information on the emerging risks and proposed responses.

The PRA veto

There are circumstances where the PRA may need to overrule the FCA, but it should be clear how and when this should happen…

We support the proposal that the PRA has a veto over the FCA but we would urge that the planned MoU between the PRA and FCA sets out detail on the types of circumstances when the veto would be used. These circumstances should generally be limited to occasions where failure to use the veto might give rise to, or worsen, a specific threat to financial stability or disorderly failure of a firm.

The MoU should also set out the circumstances under which the PRA should be permitted to use its veto in relation to rule making or waivers. One key element of this should be that the PRA should be

required to justify the use of its veto in relation to rule making and waivers.

International coordination

Formal and senior coordination is necessary if the UK's voice is to be heard internationally…

UK representation on international and European regulatory bodies, committees and fora is essential if the regulators are to achieve their financial stability objective. The Consultation proposes that legislation should require an MoU to be put in place between the various interested bodies, recognising the practical difficulties that the bodies may encounter when trying to speak with a single, powerful voice internationally.

We believe that even a well constructed, carefully managed MoU is unlikely to be effective on its own in coordinating this type of detailed work at a practical and operational level. We therefore propose mandating the establishment of an executive level international coordination committee, directly accountable to Boards of the regulatory bodies. The committee would be comprised of representatives of the PRA and FCA and would oversee and be responsible for the regulators' international engagement. The committee's mandate would include:

- coordinating involvement, influence and lead responsibility on new and developing regulatory proposals and later stage policy engagement;
- planning and implementing a long term strategy for UK regulatory interaction with the EU and international agenda, including ensuring that the UK view is well represented in the ESAs;
- managing the UK's response to international regulatory developments which impact UK firms directly, for example decisions taken by the ESAs;
- approving key areas of policy position and resolving areas of conflict; and
- managing the regulators' responses to significant international issues.

The regulators must also ensure that they are well coordinated when dealing with overseas regulators of international firms domiciled in the UK. The dual structure might give rise to confusion for some overseas regulators who could be unfamiliar with the structure, and having a single point of contact will help manage communication and the general relationship. We believe that the PRA should normally act as the main point of liaison for overseas regulators.

Shared services

Combining functions will help manage coordination as well as improving efficiencies…

The consultation does not specifically discuss the operational structure of the regulators but we believe that there should be scope to establish a number of shared services arrangements which can either be outsourced from one firm to the other or can be established in a third entity.

The establishment of shared services will clearly have some benefits and efficiencies for the regulators' costs but its importance relates primarily to simplifying their operational arrangements, firm interaction and transfers of staff between the organisations.

Although it is recognised that the two regulators will have separate remits and will need to exercise operational independence, this will help ensure a practical minimum of duplication for dual regulated firms, and promote consistency in the data required of and provided by firms.

Authorisation process

A lead regulator should manage each authorisation, drawing on the skills and expertise of the other to ensure that the right decision is taken…

The authorisation process is already a complex one and the proposed approach is likely to make

this longer and more complicated. Running parallel authorisations would lead to duplication of resources but, more importantly, would run the risk that important elements of the applicant's business model or controls go unchallenged. It is important that there is a single lead to each authorisation to manage the full administrative process but also to see the bigger picture.

We support the alternative approach raised in the consultation, with the authority with prudential responsibility taking the lead role.

Prudential supervision of investment firms

Clear and transparent criteria for the supervisory division should be consulted on at an early stage...

We support the overall scope of responsibilities for each of the main bodies, including the approach that will be used to decide the supervisor for full scope investment firms. However, this split will pose challenges for coordination, particularly where there are firms of different sizes in the same peer group. It is essential that firms have certainty about who their prudential supervisor will be over time and that firms are, where possible, supervised with their peer group. There is otherwise a risk that the regulatory structure favours one firm over another or acts as a barrier to entry to certain markets or business models.

Clear and transparent criteria for the division of supervisory responsibility should be consulted on at an early stage. If peer groups are split between regulators, specific arrangements should be put in place to ensure proper coordination.

3. Governance

The governance arrangements in place at the regulators and across the regulatory framework itself must ensure that the regulators focus on their objectives and principles and must reflect the needs of the businesses they oversee.

The governance of the FPC and regulators

We support the proposed governance arrangements for the FPC and the regulators…

We generally support the overall governance and transparency arrangements of the FPC and the regulators but believe that there remains a significant concentration of power in the Governor of the Bank of England.

The PRA and the FCA will have a majority of non-executive directors but the FPC will have only four independent members in addition to the CEO of the FCA, which will be a minority. This arrangement mirrors the Monetary Policy Committee but we believe that there is a strong argument for having a majority of independent representatives. This will allow the committee the independence and freedom to focus on its own objectives.

Representation on the key committees

Sectoral expertise is needed on the top committees to set the tone for the regulators…

We note that there is no guidance given on the characteristics that the independent members of the FPC or the non executive directors of the FCA or PRA's Board must have. We believe it is important that the committee and Board members are able to give a balanced view of the industry as a whole.

For example, the interim FPC's experience is weighted towards the banking industry, with little practical insurance experience. There is a risk that issues that arise in the insurance sector are missed or misunderstood if the Committee members do not have sufficient practical insurance experience.

The tone set by the senior committees will be reflected throughout the organisation and it is important that the organisation is not concentrated too heavily on any one sector, otherwise an unconscious bias may arise in the focus of the organisation. This may work satisfactorily when combating existing risks but it will not help identify and manage unexpected or emerging risks outside the sectors which are currently perceived as most risky.

The experience of the Boards and the FPC, when taken as a whole, should be able to demonstrate understanding, practical experience and knowledge of all of the largest parts of the UK financial sector. This will include both wholesale and retail businesses, as well as insurance, financial markets and securities, and banking.

4. Financial Conduct Regime

There are a wide range of changes proposed for the way in which conduct of business is regulated in the UK. Some of these changes may give rise to risks for firms, their customers and the regulator and further consideration of how they will be implemented is needed.

Risk appetite and interventionist approach

The FCA's regulatory approach should reflect the need for efficiency and choice in the market, for consumers to take responsibility for their decisions and for firms' management to have ultimate responsibility for their businesses…

We welcome the FCA's proposed first and second objectives that require the FCA to facilitate efficiency and choice in the market while securing an appropriate degree of protection for consumers and the regulatory principle that recognises that consumers should take responsibility for their decisions. However, the consultation paper emphasises that in some circumstances the FCA will have a lower risk appetite than the current regulator and will tend to act in a more interventionist manner, putting the prevention of consumer detriment at the heart of its operational model.

It is important that the FCA's move towards issues based supervision reflects the regulatory objectives and principles and that it does not try to become a consumer champion.

Transparency, disclosure and early publication

A stronger case needs to be made for the use of some of the FCA's proposed new powers…

The consultation discusses a number of new tools that could be granted to the FCA, many of which will be effective when used appropriately, for example ordering firms to withdraw misleading financial promotions.

It is proposed that the FCA's new tools will include the use of transparency and disclosure and the early publication of enforcement action. We are wary that this power could have a severely detrimental effect on a firm against which it was used, both immediately as the warning damaged its product or sales strategy and over the longer term as its reputation is affected. Even if a 'notice of discontinuation' was issued, it is unlikely that this would repair any damage that had been caused.

Almost by definition, it is likely that this power is only used where there is a disagreement between the firm and the regulator as to the facts or interpretation of the issue. This is the time when independent decision making and the right of appeal are most important.

There have, historically, been examples of FSA enforcement actions that have not been taken forward or have been challenged. Under these proposals significant reputational damage could have been caused.

Even where enforcement action is not being considered, transparency and disclosure of other information can pose significant reputational and economic risks to firms. Firms from across the financial sector, both retail and wholesale, would be concerned if information that was disclosed that allowed strategic information to be inferred. But the main danger of disclosure is that data can, and is likely to be, misinterpreted by consumers and the media.

The risks that these tools present for firms who are acting in a fair, honest and compliant way are sufficiently high that we believe further and detailed explanations and consultations on their practice are required.

Product intervention

Further details are needed on how product intervention powers might be used…

Product intervention powers are by their nature difficult to use effectively, even when there is no intention to use them to pre-approve products. They require regulators to work closely with the industry and take a flexible regulatory approach in order that product choice and diversity is not stifled and that the industry can respond to the demands of their customers. In principle, market based regulation should be used in preference to product regulation, although we recognise that there are circumstances in which product regulation can be effective if used selectively and in a well designed framework.

More detail is needed on how product regulation will sit alongside the distribution driven model, which should be the primary regulatory mechanism, and what the triggers for its use will be. Appeal mechanisms will also need to be defined carefully so that individual firms or groups are able to challenge the regulator's judgements quickly and receive an independent hearing.

We note that the Government will consult further on the principles governing its product intervention power.

Wholesale regulation

Further consultation is required on how the FCA's more interventionist approach might affect wholesale firms…

The Consultation focuses on the retail side of the FCA's responsibilities, but the powers that it is granted may also be used in respect of wholesale markets. The Regulatory Principles should lead the FCA to tailor its approach to wholesale market supervision. But it is important that the FCA sets out in more detail how its approach will differ for wholesale firms and their wholesale clients and the circumstances when it might apply its new powers to them.

The FCA will need to maintain strong wholesale supervisory and markets teams even where the focus of the majority of its regulatory actions relate to retail customers.

The Financial Ombudsman Service

The FOS should work closely with the FCA to improve the process for firms and consumers…

We support the proposal to maintain the FOS as an independent dispute resolution service, although we believe that there is an opportunity to improve the way that it works with the regulator.

FOS, for example, should be required to undertake analysis of the complaints that they receive in order that they can report new sources of detriment to the FCA. This will enable a far more prompt reaction from the regulator to emerging issues. The FOS must, however, view complaints in the light of the conduct rules and guidance existing at the time of the complaint.

5. The prudential regulatory regime

A new approach to prudential supervision is welcome, but further consultation is needed, and there are concerns about how it will be implemented in practice.

The FPC's macro-prudential powers

The FPC should consult widely when developing its policy statement…

We welcome the range of powers and tools proposed for the FPC and agree that the FPC should set out clearly how and when it intends to use the tools. As part of its policy statement, the FPC should indicate:

- how and when it would choose to use the powers, and what the triggers might be;
- the practical and political constraints and risks that are associated with each tool and how they might be overcome;
- how the use of the tool is consistent with international standards and how its use will be coordinated with overseas regulators and European and international bodies; and
- how the success of a power or tool might be measured and when, after being deployed, it would be reassessed.

The FPC should consult on its policy statement proposals with the financial services industry and more widely to ensure that the right tools are made available and that they are deployed in the right way, drawing firms' international experience. Consultation will also provide a mechanism for all stakeholders to buy into the use of the tools, and help to ensure that the full range of tools will be available for the FPC to use in practice.

There may be circumstances where the FPC wishes to use tools without the need for a full consultation and cost benefit analysis. However, given that the tools are designed to have effect over the medium to long term, these circumstances should be limited.

Rule making powers

The PRA should be able to provide guidance to firms on their requirements and expectations…

The PRA will have powers to make rules and will set out statements of 'purpose' to allow regulated firms to understand the rationale behind the rules and their desired outcome. The PRA will not be able to provide guidance, however.

There will always be a balance between producing rules that are proscriptive but certain and those that allow flexibility while meeting the regulator's objective. The difficulty can come when there are differences of interpretation or expectations between firms and the regulator. This is when guidance is most useful.

There is a risk that removing the regulator's ability to provide guidance will make it more difficult for firms to understand the regulator's expectations, particularly those which do not have close and continuous relationships with the FSA. As an illustration, BIPRU 2.2 is almost entirely guidance and sets out the FSA's expectations as to how firms should approach the ICAAP process. A combination of rules and statements of purpose would provide firms with very little idea of what the FSA's requirements for the documents are.

There are risks for the regulator, firms and business more generally in rules being misinterpreted, whether that results in firms not meeting the regulator's standards, or if it results in them going too far.

We agree that the PRA should be able to use rules and statements of purpose, but it should not be prohibited from developing guidance where that would produce a better outcome. This will not conflict with the proposed judgement led approach and is essential for a regulator which intends to be more interventionist.

A judgement-led approach

The ground rules for the judgement led approach must be clear and the regulator must have sufficient resources for it to be effective…

Where supervisors are applying their judgement, there is still a need for their decisions to be based on objective evidence. Otherwise there is a risk that the judgement led approach becomes a subjective approach, and one that lacks consistency. The regulator must set out its expectations for how its judgements are discussed with the firms it supervises, their rights to debate and appeal and how it will maintain consistency.

The proposed judgement based approach to regulation will also be resource intensive and will require supervisors that have a flexible skill set and detailed understanding and experience of the business models of the firms they supervise. Supervisors will also need to be close to and have current knowledge of the markets that they oversee. The regulator should provide more detail on how it intends to develop and maintain these resources and skills in its line supervisors.

For further information please contact:

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Appendix A – Summary of consultation questions

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

See section on 'The FPC's macro prudential powers.'

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

See section on 'The FPC's macro prudential powers.'

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

See section on 'Independent Representation on the Key Committees'

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

See section on 'Competitiveness'

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

See section on 'Prudential supervision of investment firms'

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

See sections on 'Authorisation', 'Rule making powers' and 'A judgement led approach'.

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

See sections on 'Governance'.

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

See sections on 'Governance'.

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

We agree that the PRA should be under a duty to consult with practitioners and would welcome the opportunity to comment on more detailed proposals on how the regulator will approach this as soon as possible.

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

See sections on 'Regulatory Objectives and Principles'.

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

See sections on 'Governance'.

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

See section on 'Product intervention'.

14 The Government would welcome specific comments on:

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

See section on 'Transparency, disclosure and early publication'.

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

See section on 'The FCA and Competition'.

16 The Government would welcome specific comments on:

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

The CBI welcomes decision for the UKLA to remain part of the FCA.

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

See section on 'Coordination'.

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

See section on 'Coordination'.

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

See section on *'Authorisation'.*

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

We support the proposals that the PRA will have responsibility for liquidity and overall financial stability while the FCA will have responsibility for inward passport administration and conduct of business. Each will have responsibility for the financial soundness of the outward branching firms that they supervise for prudential purposes. We caution, however, that close coordination will be needed if all the risks arising from inward passported firms are identified. This has, in the past, been an area where significant risks have crystallised and we would welcome further details on how this coordination will be approached.

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

See section on 'Coordination'.

25 The Government would welcome specific comments on

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

We support the proposals on group supervision and the power of direction over unregulated parent entities.

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

See section on the 'Financial Ombudsman Service'.

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

See section on the 'Financial Ombudsman Service'.

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

See section on 'International Coordination'.

Appendix B - Questions to which the CBI has chosen not to respond

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

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

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

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

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

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

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

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

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Financial Regulation Strategy
HM Treasury
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12 April 2011

Dear Sir/Madam

A new approach to financial regulation: building a stronger system

The Consumer Council is an independent consumer organisation, working to bring about change to benefit Northern Ireland's (NI) consumers. Our aim is to make the consumer voice heard and make it count. We represent consumers in the areas of transport, water and energy. We also have responsibility to educate consumers on their rights and responsibilities and to equip them with the skills they need to make good decisions about their money and manage it wisely.

We have been working with Government and other stakeholders including banks and building societies to ensure financial services and products are suitable for consumers. Through partnership, we drive change and ensure that consumers are at the centre of policies and decisions.

The Consumer Council has been campaigning to ensure that consumers are protected from unfair bank charges and has asked the Government to address the problem of fragmented personal current account regulation, caused by the split between the Office of Fair Trading (OFT) and the Financial Services

Authority (FSA). The Consumer Council has raised concerns that this regime causes uncertainty for the protection of consumers due to the responsibilities being split between bodies.

Main principles to protect consumers

We have previously outlined our policy positions on regulation and how it protects consumers to the Treasury.

The Consumer Council recommends four main principles to be taken into consideration to protect the interests of consumers throughout financial regulation reform.

Clarity for consumers:

The Consumer Council would like to see clarity for consumers restored in the new regulatory framework with the provision of a charter that clearly outlines the responsibilities of both consumers and financial institutions. Customer facing aspects of regulation should be consistent, granting consumers the same rights whether they complain about elements of products such as an overdraft or a savings account.

There must be complete clarity around the ability of each regulator to take decisions within its area of focus and expertise so that important tasks and issues that protect consumers do not fall between the bodies.

The proposed names of the new institutions do not give a clear indication of their roles. These could be confusing for consumers. For example, the Money Advice Service (MAS) only provides information to educate consumers and is not a debt advice service as the name may suggest. As the focus of the organisation is encouraging consumers to help themselves, this may not be helpful for consumers to know who to go to. Additionally, the Financial Conduct Authority (FCA) would benefit from extra wording in the title relating to consumer protection. We seek assurance that the roles of the new bodies will be communicated clearly so that all consumers understand how they will be protected and where to seek redress if appropriate.

A robust and flexible system:

Much more work is needed to empower consumers to make informed decisions. Improvement in the transparency of information provided to consumers on their services, charges, rights and responsibilities is key to ensuring consumers can make informed choices. Consumers can only take responsibility for their actions when they are financially capable. They need to have all the relevant information to make the decision, alongside the appropriate redress should things go wrong.

The system must be robust enough to identify financial products or behaviours that will cause customer detriment. The system must also be flexible enough to respond urgently to identified detriment and take necessary and appropriate actions. The FCA must ensure that the interests of consumers are placed at the heart of the conduct regulatory system and given the appropriate degree of priority. The level of protection offered to consumers throughout the transition period (as powers shift from the FSA) should be maintained and communicated to consumers so that they are able to take responsibility for their decisions.

In 2007 the Northern Ireland personal current account market was found to be anti-competitive by the Competition Commission inquiry, established in response to the Consumer Council supercomplaint. While we recognise the commitment made by the banks to make changes that will benefit consumers, we urge the FCA and banks to work together to ensure that consumers are at the centre of policies and decisions that affect us all.

We believe that the FCA must conduct detailed supervision and testing of all banks across the UK. The current FSA strategy concentrates on the larger banks which make up a large percentage of the UK market. This means that not all banks operating in Northern Ireland are receiving the same robust and persistent supervision. Therefore, a more detailed level of testing should be extended to Northern Ireland, especially given the findings of the Competition Commission in 2007.

The role of the new FCA should be to protect consumers in both a preventative and restorative manner. This should be in the form of credible enforcement of an appropriate set of conduct rules and the safety net of an ombudsman and compensation scheme to allow effective redress.

As lack of competition in the market place has previously been raised as a problem in Northern Ireland. The FCA should identify issues in the market and promote competition to improve the options available to consumers. If the market conditions are sound, the work of the Consumer Council and other bodies involved in the Financial Capability Partnership NI would go further in helping consumers be able to compare financial products and switch bank account.

Financial service providers should work with government agencies and the Consumer Council to design products and structures that help all consumers to access and benefit from services such as bank accounts and insurance.

There should be better engagement with consumer groups from the regulators. This would help to shape research and provide better solutions for consumers. Early consultation and engagement though phone calls and meetings alongside formal consultation would be beneficial.

Frequent reviews of the system:

Proper mechanisms must be put in place to review the regulation system and to take into account the views of consumers gathered by consumer representatives on a frequent basis. This should include the involvement of the independent consumer panel. Cooperation and sharing of information between the regulators is necessary to strengthen transparency and accountability.

Consumer education:

We welcome the establishment of the UK's first free financial guidance service and annual financial health check. It is vital that organisations such as the newly named Money Advice Service continue the approach of working in partnership with organisations such as the Consumer Council and the Financial Capability Partnership NI to ensure there is a joined up approach and there are consistent messages on financial capability.

Further consultation with the Consumer Council

We look forward to working with the Treasury and reviewing more detailed proposals, including the draft legislation. We hope you will find this information useful. If we can provide you with any further information please do not hesitate to contact Maeve Holly, Senior Consumer Affairs Officer on 028 9067 4820.

yours sincerely,

Aodhan O'Donnell
Director of Policy and Education

CONSUMER CREDIT Counselling Service

A Registered Charity

Response to HM Treasury consultation on: A new approach to financial regulation: building a stronger system

Introduction

The Consumer Credit Counselling Service (CCCS) is the UK's largest dedicated provider of independent debt advice. Last year the charity helped 418,000 people with free advice and delivery of support services, including Debt Management Plans (DMPs), bankruptcy and welfare benefit checks – we are geared up to help many more. We welcome this opportunity to comment on HM Treasury's consultation on a new approach to financial regulation.

CCCS is run independently of taxpayer money on the basis of a unique set of relationships with the all the major banks, credit card companies and other creditors – our funding model means we can provide impartial advice and specialist insolvency support as people need.

CCCS is committed to improving the situation of households in financial distress. By the end of 2010, our over 800 full time staff were managing almost £3.6 billion of unsecured debt.

CCCS experienced a 35 percent increase in demand for its services as a result of the recession, helping almost half a million people in 2009 alone. This would doubtless have been of interest to the FPC had it been around.

Given the nature of the problems our clients face, the key concerns of CCCS centre on the issue of consumer detriment. In general, this can come about in two ways:

- from conduct problems – for example, when products are badly designed or missold
- from macro-economic/prudential factors, such as interest rate variations or general economic tightening, which can impair consumers' access to needed credit or ability to service existing debts.

The FPC, through the PRA, will have powers to influence outcomes in the latter sphere; however these could in certain cases have severe adverse impacts on consumers.

For instance, there is potentially a tension between the prudential desire to see banks rebuild their profitability and the impact on consumers of the price and margin increases required to deliver this. For example, focusing on consumer loans, we have already seen a noticeable widening of interest

margins since the financial crisis. Further, a minority of lenders continue to levy interest and charges on loans in arrears, even when CCCS has put in place sustainable arrangements for debt repayment.

The PRA needs to have regard to the impact on consumers of pricing and other relevant changes that banks may seek to introduce on supposedly prudential grounds.

Such impacts are outside the conduct remit of the FCA, which is not, and cannot be the direct protector of consumers in this area. Therefore, CCCS believes:

- The FPC/PRA should have regard to the impact that their policies and actions may have on consumers (in the same way as they are mandated to avoid "significant adverse effects on the capacity of the financial sector" (Box 2.B))
- There should be consumer representation on the FPC and PRA (as we suggest in our response to Q3 and Q8)
- The PRA should retain a consumer panel. It is not enough for there to be a duty to consult with the FCA, as the effect of prudential decisions on consumers will not necessarily be within the FCA's remit.

Our response to the following consultation questions is based on their relevance to our work and the interests of our clients.

Q1. What are your views on the likely effectiveness and impact of these instruments as macro-prudential tools?

Q2. Are there any other potential macro-prudential tools which you believe the interim FPC and the Government should consider?

We are concerned that neither the FCA nor the PRA nor FPC has a remit to look at (unsustainable) consumer behaviour. Lack of oversight poses a particular risk in the unsecured credit market, where consumer detriment is most severe. In view of plans to transfer the regulation of consumer credit from the OFT to the FCA, we are concerned that consumer behaviour in this market could fall through a supervisory gap.

While the PRA has a remit to watch for and deflate credit bubbles, we also need to make sure the new regime takes account of whether households are taking on unsustainable levels of debt. This is of particular concern given the OBR's forecast at this year's Budget that household debt-to-income ratios will become increasingly unmanageable and soon top pre-crisis levels[1]. We hope that as part of the FPC's remit to guard against unsustainable levels of debt, it will take into account data already available through existing channels, such as that provided by CCCS.

[1] See Table 1.8 of the OBR's supplementary economy tables to its Economic and Fiscal Outlook

Q3. Do you have any general comments on the proposed role, governance and accountability mechanisms of the FPC?

We believe the FPC should have regard to the interests of consumers in its decision-making. Decisions taken by the FPC, in particular, could have far-reaching consequences for the financial sector and the economy more widely. They may also have far-reaching consequences for consumers of financial services. It will therefore be important for the FPC to take the impact on consumers into consideration when pursuing its primary objective.

However, we fear there may be pressures to put prudential concerns ahead of consumer concerns. For this reason, we believe that there needs to be consumer representation among the non-Bank members of the committee to boost confidence that the new regime is not tilted in favour of financial service providers.

Q4. Do you have any comments on the proposals for the regulation of systemically important infrastructure?

Q5. What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the PRA?

We believe the PRA should have regard to the primary objectives of the FCA. Given the veto power of the PRA, this would bolster confidence in the new regulatory regime that the new bodies are of equal status.

Q6. What are your views on the scope proposed for the PRA, including Lloyd's, and the allocation mechanism and procedural safeguards for firms conducting the 'dealing in investments as principal' regulated activity?

Q8. What are your views on the proposed governance framework for the PRA and its relationship with the Bank of England?

Q9. What are your views on the accountability mechanisms proposed for the PRA?

We are concerned that substantive accountability mechanisms for the PRA do not exist in the absence of significant regulatory failure (3.55 – 3.39). Given the experiences of our clients with the financial institutions to be regulated by the PRA, we believe the accountability of the regulator to Parliament should be ongoing.

Q10. What are your views on the Government's proposed mechanisms for the PRA's engagement with industry and the wider public?

We are concerned that plans to scrap the consumer panel for the PRA will place consumer concerns at a further remove from the decision-making process. First, although the FCA has a consumer protection agenda, unlike the panel it is not set up to represent consumer concerns. Second, it is

possible that the effect of prudential decisions on consumers will fall outside of the FCA's remit. Therefore, scrapping the PRA's consumer panel and bringing in a weaker 'duty to consult' the FCA distances consumers further from prudential decision-making. To ensure that consumer issues are at the heart of the new regime, the Government should retain a consumer panel for the PRA and ensure that the body has non-executive consumer representation.

Financial Conduct Authority

Q11. What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the FCA?

Q12. What are your views on the Government's proposed arrangements for governance and accountability of the FCA?

We believe it would be desirable for members of the FCA governance team to have experience of consumer advocacy – this would add credibility to the authority's consumer protection agenda.

We would prefer to see positions of governance at the FCA filled through a process of open competition rather than Treasury appointment.

Q13. What are your views on the proposed new FCA product intervention power?

The new FCA product intervention power is a welcome tool for early action to prevent consumer harm. We believe services should be included under the definition of a product or subject to a similar intervention power. For example, this might cover the unfair charging structures of many providers of debt management plans (DMPs). In our view it is simply unjustifiable for DMP providers to charge upfront fees. Not only do they push vulnerable clients even further into debt, but they also drive an aggressive sales culture and are one of the driving forces behind inappropriate advice.

Q14. The Government would welcome specific comments on:

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

We welcome the FCA's new power to direct firms to withdraw misleading financial promotions and believe that it must cover consumer credit services, like debt management plans.

We also welcome the FCA's new power to publicise the fact that it is initiating action against a firm – in the case of consumer credit, this is long overdue.

It will be important to make sure that the FCA is well resourced. We believe that the OFT's monitoring of debt management firms and enforcement action against them has in the past been undermined by a lack of resources.

Q15. Which, if any, of the additional new powers in relation to general competition law outlined above would be appropriate for the FCA? Are there any other powers the Government should consider?

Regulatory processes and coordination

Q16. The Government would welcomes specific comments on:

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

Q17. What are your views on the mechanisms and processes proposed to support effective coordination between the PRA and the FCA?

We are concerned that plans to ensure the PRA has regard for the objectives of the FCA have been dropped (5.10). If the relationship between the prudential and consumer regulator is not balanced, ordinary consumers of retail products may continue to lack the degree of regulatory focus or protection they expect or require.

While, within the proposed framework, the FCA has the strategic objective to protect and enhance confidence in the financial system, it must also be vigilant against firms justifying anti-consumer pricing and charging practices on prudential grounds.

Q18. What are your views on the Government's proposal that the PRA should be able to veto an FCA taking actions that would be likely to lead to the disorderly failure of a firm or wider financial instability?

Q19. What are your views on the proposed models for the authorisation process – which do you prefer, and why?

Q20. What are your views on the proposals on variation and removal of permissions?

Q21. What are your views on the Government's proposals for the approved persons regime under the new regulatory architecture?

Q22. What are your views on the Government's proposals on passporting?

Q23. What are your views on the Government's proposals on the treatment of mutual organisations in the new regulatory architecture?

Q24. What are your views on the process and powers proposed for making and waiving rules?

Q25. The Government would welcome specific comments on

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

Q26. What are your views on proposals for the new authorities' powers and coordination requirements attached to change of control applications and Part VII transfers?

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

Q28. What are your views on the Government's proposals for the new authorities' powers in respect of fees and levies?

CFEB (now the Money Advice Service) is currently funded through a levy on banks and financial service providers. However, if it takes on a co-ordinating role for debt advice, there is a strong case to broaden the levy to include utility companies to whom a significant amount of problem debt is owed. Debt comes from two or three main areas and we'd expect the government to take this into account. Our proposal could be implemented in co-ordination with the energy regulator, Ofgem, to ensure that those who receive part of the benefit of debt advice make a proportionate contribution to its delivery.

Compensation, dispute resolution and financial education

Q29. What are your views on the proposed operating model, coordination arrangements and governance for the FSCS?

Q30. What are your views on the proposals relating to the FOS, particularly in relation to transparency?

The role of the FOS should not be lost in the new regime. It is particularly the case that those who have fallen into debt need a swift and impartial dispute resolution service in their dealings with creditors.

Q31. What are your views on the proposed arrangements for strengthened accountability for the FSCS, FOS and CFEB?

Consumer Credit Counselling Service
April 2011

Consumer Focus
Campaigning for a fair deal

Consumer Focus response to HMT consultation on a new approach to financial regulation: building a stronger system

April 2011

About Consumer Focus

Consumer Focus is the statutory consumer champion for England, Wales, Scotland and (for postal consumers) Northern Ireland.

We operate across the whole of the economy, persuading businesses, public services and policy-makers to put consumers at the heart of what they do.

Consumer Focus tackles the issues that matter to consumers, and aims to give people a stronger voice. We don't just draw attention to problems – we work with consumers and with a range of organisations to champion creative solutions that make a difference to consumers' lives.

Contents

A new approach to financial regulation: building a stronger system

Overview

Consumer Focus welcomes this consultation on the new regulatory structure. Our response is mainly concentrated on the role of the Financial Conduct Authority (FCA) and its relationship with the Prudential Regulation Authority (PRA), Financial Ombudsman Service (FOS), Consumer Panel and Money Advice Service. We are encouraged by our analysis of the proposals on objectives and powers of the proposed new regulator but strongly believe there are areas where consumer protection will need to be further strengthened.

The proposed changes will require a complete culture change from the regulator, and new skills and ways of thinking. It is important that the foundations for culture change are laid early to provide industry and consumers with a clear statement that this is not the same body with a new set of clothes.

The concurrent consultations on simple products and on product intervention along with the proposed transfer of the Consumer Credit regime to the FCA also have the potential to lead to far-reaching changes to consumer protection.

As Mervyn King recently noted banks exploit „gullible or unsuspecting" customers.[1] We do not support unnecessary regulation, as this is not in the consumer interest. However, in financial services, it is not helpful to talk about regulation as a „burden", given that the case for intervention here is to:

- correct substantial market failure
- provide safeguards against any repetition of past industry irresponsibility
- remedy a significant imbalance of power between industry and consumer

Our experience is that effective regulation will promote a better market place with more efficient product and service provision. We do not want to see the continued emergence of regular misselling scandals or unsafe practices involving high consumer detriment and huge numbers of complaints to the FOS. As Adair Turner comments in the FSA Annual Report, 2009/10, „this periodic process of large scale customer detriment and then customer compensation is not an acceptable or sensible model for the future."

The current system rewards inefficiency and entrenches advantage instead of supporting the stability of the market and the interests of consumers. It is vital that, under the changed regulatory structure, new entrants and those who are more flexible and better able to respond to consumers" needs are able to flourish. The fact it is proposed that the FCA should have a duty to use competition as a tool to promote consumer protection will prove helpful in this respect.

[1] Mervyn King: *Bankers exploit gullible borrowers to pay for their bonuses* on gurardian.co.uk: **http://bit.ly/fzTUbc**

Financial Policy Committee

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

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

We agree that, if the Financial Policy Committee (FPC) has the objective of contributing to the „Financial Stability Objective" of the Bank of England („the Bank"), it should have the tools to do so effectively. However, as the Treasury Select Committee (TSC) points out, „many macro-prudential tools are only now being developed, and their effectiveness will need to be monitored".[2] The potential impact on consumers must be a key consideration in relation to the FPC's proposed use of any macro-prudential tools.

In *Feast to famine*[3] by the Financial Inclusion Centre (commissioned by Consumer Focus), counter-cyclical capital requirements were suggested as a potential prudential tool, which would enable regulators to encourage lending during an economic downturn and rein in lending during a credit boom.

In terms of weighting capital requirements differently according to risk, as the paper recognises, the correct identification of risk is not a straightforward task. We are committed to promoting diversity in the market and would be concerned if increasing capital requirements on institutions that are considered risky created greater barriers to those institutions that are genuinely offering different models of financial services, which could benefit consumers.

The recent interim report[4] from the Independent Commission on Banking (ICB) noted the subsidy to the banking sector was significant and well in excess of £10 billion as a result of the implicit state subsidy reducing the cost of borrowing. The report also noted the larger the bank the larger the subsidy. Therefore, in order to create diversity the FPC will need to reflect not just on safety and risk but also the need to ensure a diversity of offerings, fair competition between larger and smaller banks and effective consumer choice.

Finally, the nature of the tools is important, but the willingness to use them in appropriate circumstances and the manner of execution will determine their effectiveness and impact.

3. Do you have any general comments on the proposed role, governance and accountability mechanisms of the Financial Policy Committee?

Our concern with the placement of the FPC and PRA in the Bank of England is that central banks have never been particularly open or transparent about their operations. There need to be robust mechanisms in place to ensure transparency and a high degree of accountability in relation to the FPC.

Furthermore, the membership of the FPC is weighted in favour of the Bank of England. While the paper acknowledges the importance of the „non-Bank members" in terms of contributing their experience and views, we are concerned that the impact of these contributions will be compromised by the Bank's dominance within the FPC. Increasing the influence of external members on the FPC would have the added benefit of

[2] Financial Regulation: a preliminary consideration of the Government's proposals, Treasury Select Committee, February 2011, page 26
[3] Financial Inclusion Centre, *Feast to famine*, April 2009
[4] Independent Commission on Banking Report April Interim 11 2011

counteracting the perception of the Bank as an „advocate of City interests within the Government"[5].

We support the financial regulatory system having access to a wide variety of skills and knowledge to ensure its effectiveness for consumers. This should be the case for all of the regulators within the new system. However, it is envisaged that the four independent members of the FPC will have „direct experience as financial market practitioners". Thus the FPC is entirely made up of financial industry representatives. We believe that the independent membership of the FPC should be broadened out to include those with consumer, economic, public policy and other relevant experience.

Prudential Regulation Authority

Questions 5 to 10

Strategic and operational objectives proposed for the PRA

We agree that ensuring the stability of the UK's financial system is an important goal. In order to plan for their futures and participate in both society and the market place consumers need to have confidence that their savings and investments are safe and that credit is available both for themselves and for the companies that provide them with goods and services. Consumers as taxpayers also need to have the confidence that the wider economy will develop sustainably rather than be subject to cycles of boom and bust or, worse, hit with the recessionary fall out of full scale banking crisis and bailout.

However it is possible to have stability but at the same time to have a system that serves consumers poorly in terms of the choice and quality of the financial products available to them.

In this context, the goal of the FCA to protect consumers may come into conflict with the PRA's objective for stability which could, at least in theory, mean that toxic products or misselling are not addressed where the practices are so entrenched or widespread that the costs of correcting behaviour are deemed too risky for overall stability.

Given the waves of misselling outlined in the FSA's product intervention paper there is a real possibility of such practices occurring again. The new regulator should be equipped so as to have the ability to both identify and address the detriment at an early stage. However in circumstances where the early intervention does not occur, later action will be necessary and a veto by the PRA on FCA action could lead to consumer harm.

We note that the Government is not proposing the PRA should have regard to the objectives of the FCA and vice versa and is instead proposing that there be a general duty to co-ordinate and consult each other on views. In such a model an effective relationship between the two organisations is vital to avoid conflict or paralysis. A formal mechanism for co-ordination and conflict resolution needs to be put in place at the outset of the new structure.

We have stated above our concerns regarding the PRA being placed with the Bank. The paper justifies bringing the PRA within the Bank on the basis that it will lead to „improved co-ordination and harmonised action" between the PRA and the Bank. Our concern is that, being a subsidiary of the Bank may compromise the independence, transparency and accountability of the PRA in relation to its own micro-prudential remit. The potential for such issues to arise is evident from the fact that the executive members of the PRA board will largely be made up of Bank officers and the Bank will retain full responsibility

[5] John Kay in *The new financial services leviathan: has competition been a casualty of the financial crisis*, in Consumer Focus, *Rethinking Financial Services*, June 2010

for the appointment of members to the PRA Board. We would expect to see detailed proposals setting out clearly how it is proposed that the potential difficulties would be avoided. It is disappointing therefore that the consultation paper remains somewhat vague in this regard.

We also consider that there should be a diverse representation of consumer, public policy, regulatory, economic and industry expertise across the regulatory regime, including in respect of the PRA.

Accountability

The consultation paper sets out a number of welcome ways in which the PRA should be held accountable. We would add an obligation for the PRA to be required to explain why it has had to resort to any veto on an intervention by the FCA. A veto of an intended action by the FCA implies the likelihood of regulatory failure, by either the FCA or PRA or both, to take prompt corrective action to curb practices or products before they threaten stability. We talk more about the veto later on in this response.

Engagement

The scope for engagement by the PRA with consumers is limited to the ability for the wider public to comment on its annual report and the extent to which it has met its objectives. We doubt the extent to which this measure can provide a broad consumer perspective and in that light urge the Government to take a more directive approach to ensuring genuine engagement. Part of a solution would involve the Government reconsidering its decision not to allow the PRA to engage with the consumer panel more directly. The PRA should also invite representatives from consumer groups such as Which?, Citizens Advice and charities that have an interest in financial matters (Age UK, Shelter etc) to regular working groups to assess the impact of the PRA"s decisions on the groups they represent. Other models for engagement involve the PRA meeting regularly with consumers at public events and publishing regular updates on key decisions and challenges throughout the year.

Financial Conduct Authority

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

Strategic and operational objectives for the FCA

The FCA"s stated „core purpose" of „protecting and enhancing the confidence of all consumers of financial services" is very much welcomed and we are pleased that it is now said to have consumer interests at the heart of its regulatory approach. We do not consider, however, that the FCA as envisaged will also be a „consumer champion", which would indicate a campaigning and lobbying role on behalf of consumers.

The single strategic objective of the FCA is „protecting and enhancing confidence in the UK financial system". Financial stability is fundamental to consumers in terms of the provision of low-risk sustainable products and services. Consumer protection is an essential part of that financial stability. However, it is not inevitable that consumer interests and protecting confidence in the financial system will always coincide. For example, if the survival of a firm or firms were dependent on a prevailing business model that would be curtailed by consumer protection measures, then the objective, as currently worded, could mean consumers suffered for the sake of protection of confidence in the system. Hence, we consider consumer protection should be one of the FCA"s strategic objectives.

The FCA has three operational objectives, none of which are given priority, although it is evident that there may be conflicts between them. For example, it is stated that „removing regulatory barriers" in order to stimulate competition is part of „facilitating efficiency and choice in the market". It is evident that these measures will have to be balanced with „an appropriate degree of consumer protection". It is not clear which objective will be given priority should they come into conflict. We do not oppose efficiency and choice in financial services, nor do we oppose the removal of unnecessary regulation, but this should not be at the expense of consumers or consumer protection. Hence we consider that of the three operational objectives, consumer protection should be given the highest priority if Government decides not to make consumer protection a strategic objective.

Securing consumer protection is a welcome operational objective, but we are concerned about it being qualified by the term „appropriate". It is a qualification that is absent from either of the other operational objectives and we are concerned that this might lead to it being given lesser priority. In the consultation paper, the use of the term „appropriate" is said to relate to the level of protection afforded depending on whether the consumer is a retail customer or a professional market participant. However, the objective is expressed in such general terms, that the use of „appropriate" in this context gives us some cause for unease.

Competition

We note that by requiring the FCA to discharge its functions in a way that promotes competition, these proposals put a greater emphasis on promotion of competition than the previous „have regard" approach under the Financial Services and Markets Act (FSMA). We welcome this recognition of how important competition is in ensuring well-functioning markets.

As the FSA has recently pointed out „...ineffective competition in retail financial services markets more usually results from a number of "demand-side weaknesses". By this we mean that customers are not exerting pressure on firms to produce the desired quality of products or to influence prices".[6] Consequently, it is difficult for market forces alone to provide the type of market dynamic needed. We welcome and support the ICB recent recommendations to improve switching[7].

Few consumers switch providers in financial services – our research found only 7 per cent switched personal current accounts (PCAs) over two years.[8] Most buy other financial products from the same provider as their PCA.

However competition is a means to an end and so should not take priority over other regulatory principles. Competition should be a mechanism to deliver outcomes for users. The value of competition in achieving positive outcomes for consumers must be monitored on an ongoing basis and, if outcomes are not being achieved, measures must be taken in relation to competition to ensure a rebalancing towards consumer interests. As part of this process, there should be a greater role for stakeholders, including consumers and consumer groups, to raise competition issues in relation to financial services.

The danger of competition as a goal of the regulator is that the regulator moves into the role of promoting the industry. We welcome the proposal that the FCA will not be expected to promote competition where it is not compatible with its strategic or operational objectives. A stronger guarantee for consumers would be if consumer protection was promoted to a second strategic objective.

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[6] FSA Product Intervention DP February 2011
[7] Independent Commission on Banking Interim Report 11th April 2011
[8] Consumer Focus, *Stick or twist*, 2010; OFT, Personal Current Accounts – A Market Study

Regulatory principles

We are in broad agreement with the regulatory principles proposed, but raise a few specific issues below. It is also fundamental to their effectiveness that these principles are implemented on the basis of broader evidence and transparent decision-making.

„Efficiency": There is a danger that consideration of the need to use resources in the most efficient and economic way is interpreted in such a way that it constitutes a restraint on exercising powers.

„Proportionality": Consideration of the burdens or restrictions imposed must not be conducted in isolation of the benefits or in underestimation of benefits that are either difficult to quantify or where the advocates of those benefits are less well-resourced and influential than others, who are more forcefully represented.

„Consumers are responsible for their decisions": It is a truism that consumers are responsible for their decisions. The detriment suffered by many consumers, only some of whom have ever sought or received redress, shows they are responsible and indeed suffer the consequences when things go wrong. No regulatory protection is ever going to remove consumer responsibility but regulation must ensure that when consumers face a choice the information provided enable them to find suitable products that offer fair value and predictable quality. Across a whole range of financial markets this simply is not the case. Consequently this reference to consumer responsibility appears tokenistic and largely irrelevant. We would expect the regulator to tailor their regulatory approach to ensure that the balance of responsibility lay with the industry in relation to retail customers. Previous misselling scandals have indicated that consumers are at a considerable disadvantage when dealing with the financial services industry in terms both of complexity of products on offer, the fact that detriment may take many years to crystallise and the ability of banks to design products around consumer's behavioural biases. Steps to improve the financial capability of consumers are welcome, but they are unlikely to change the power imbalance between the retail consumer and financial services provider and should not be seen in that light.

„Transparency": We are very supportive of improving the transparency of the regulator, particularly with regard to improved consumer engagement. We give further comments in respect of transparency as a regulatory tool below.

We strongly urge the Government to reconsider its decision to remove the promotion of financial inclusion as a „have regard". While we agree that financial inclusion is also a social policy issue we believe that the mainstream financial institutions have a key role to play in relation to improving financial inclusion in the UK. The regulator would be in a prime position to ensure that their policies and procedures did not exclude those on low incomes or groups of consumers made vulnerable or at a disadvantage due to disability for example.

In the earlier consultation on regulatory reform we also proposed that there should be a wider public interest „have regard", incorporating issues of public understanding and essential service provision as well as financial inclusion. It is disappointing to note that this has been rejected.

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

The board of the FCA must contain a wide variety of knowledge and skills. Consumer expertise must be represented on the board as well as public policy, regulatory, economic and industry expertise and experience.

In principle, the veto the PRA has on FCA intervention and policy indicates to us that the FCA will be considered a subordinate body to the PRA and hence conduct and consumer protection issues will take second place to prudential regulation under the new regulatory regime. The FCA must have sufficient tools, independence and powers to properly carry out its consumer protection functions, and it should not be on a lesser footing than the PRA.

We are supportive of the continuation of the Consumer Panel. However, we are concerned about the lack of consumer engagement proposed under the new arrangements for the FCA. We have previously been critical of the FSA for a failure to engage effectively with consumers, and, despite recent improvements in seeking out consumer views (eg roundtables with public interest groups and charities), more needs to be done in this regard in the future. Without such an approach responses to consultations will continue to be dominated by responses from industry and its representatives.

The FCA needs to engage and provide real opportunities for consumers to contribute to its work. Its engagement strategy should provide:

- Opportunities to engage in the FCA's corporate planning processes to allow consumers to help shape the priorities of the Authority
- A „consumer radar" of emerging issues and areas of detriment
- The ability to work both with representative bodies and directly with consumers themselves

In our report Rating Regulators[9] we found evidence of good practice in engaging with consumers which the Government could consider in relation to the FCA. The Food Standards Agency, for a example could act a model for the FCA on engagement as a strong consumer-focused culture exists across the organisation. The Food Standards Agency is transparent about its activities (holing many meetings in public and having a culture with a presumption publication of documents and decision) and has well rated consumer engagement programme. Similarly the Communications Consumer Panel developed a Consumer Interest Toolkit to guide their involvement with customers of services in their sector.

Approach to conduct regulation

The FCA will be the conduct regulator for all financial institutions, but will also have prudential regulation responsibility for 18,500 firms that are not within the scope of the PRA. In due course, if the Treasury's proposals in this regard are implemented, it will have responsibility for all of the 96,000 consumer credit businesses currently regulated by the Office of Fair Trading (OFT). Thus, the proposed separation between prudential and conduct regulation of the financial services market will be only partially achieved. At the same time, the dual regulation of some firms presents a complex picture. This could give rise to confusion in terms of the responsibilities of regulators and may also prove difficult for consumers to navigate.

We are pleased to see that there will be a more proactive and interventionist approach on the part of the regulator and that, furthermore, „the prevention of consumer detriment" will be central to its regulatory model. The new conduct approach will require a complete culture change from the regulator and involve new skills and ways of thinking. It is essential that this culture change is embedded in the foundations of the new regulator otherwise it will fail to meet its stated objectives. The specific regulatory tools and powers referred to below are examples of how the FCA will be enabled to be a more „hands-on" regulator. In order to establish its credibility, it will be vital for the new regulator to demonstrate its commitment to this new conduct approach through its supervisory

[9] Rating Regulators Consumer Focus 2009

measures and enforcement action. There will otherwise be a risk that it will be seen simply as the same body in a new suit of clothes and will lose public confidence as a result.

A more proactive regime which will also encompass consumer credit businesses is likely to be highly resource intensive and very different to the current consumer credit licensing carried out by the OFT. The paper does not explain how this will be funded. We are concerned that an increase in fees will be passed on to consumers and will also prove prohibitive to smaller consumer credit businesses and may put them out of business. This could present a significant barrier to new entrants, including community-based initiatives.

13. Views on proposed new product intervention power

We welcome the new product intervention powers and discuss our views in more detail in our forthcoming response to the FSA discussion paper on this topic.

We particularly welcome the move to legislate to make provision on the unenforceability of contracts made in breach of its product intervention rules making such contracts void.

It must be clear to both regulators and industry how the new powers on product intervention can be used.

We would be concerned if the evidence burden to justify action remains as high and as narrow as it has historically been, and where consumer input has been so ignored in the past. We would call for a differing approach to evidence in product intervention than has been the case for firm-specific enforcement action for breaches to their duties under FSA licensing.

If judgements on product design are going to be under a criminal level of proof, it is likely any such judgements will take a long time, since the FSA will have to be assured it has undertaken due diligence. Equally, it will have to prove it has gone through each of the product governance obligations, systems and controls before it makes any recommendation to intervene in product design. Finally, any use of extreme measures such as bans are likely to come in place once all other measures have been tried and once changes to governance processes explored. All the while, consumer detriment may well be accruing.

There are some specific examples of where we believe the high evidence threshold has prevented the FSA from being able to act in the consumer interest. We are aware that the FSA does not undertake extensive mystery shopping. Our understanding is that this is because the scale of the exercise necessary for such work to inform enforcement or monitoring activity would be so large as to be prohibitively expensive.

Equally, it appears the FSA cannot invoke consumer groups‟ or non-governmental organisations‟ use of mystery shopping or extensive anecdotal information as hard evidence. Clearly anecdotal information or consumer group information must require further analysis and substantiating evidence but the experience of consumer groups and consumers is that such information has roundly been ignored in the past rather than providing the basis for investigation.

As it stands, it appears the proof burden necessary for evidence to be taken into account is far too rigid, exclusive and narrow. The Government may wish to reflect on how far the FSA‟s rigid definitions of evidence go to explain its self-confessed reputation for appearing remote from the consumer before the crisis, and also why the FSA was incapable of foreseeing and preventing the crisis developing.

Consequently, we would like to see a greater level of detail about the nature of how such judgements will be reached. We believe this to be critical in terms of the efficacy of „early

intervention". In any new approach to product design, the regulator"s ability to act depends on the burden of proof used in its risk matrix and what steps it must fulfil before using strong tools. We believe there is a significant risk the FCA may get caught up in process rather than acting quickly to prevent problems occurring as rapidly as it should.

The FSA has devoted significant resources into complaint handling as part of its Consumer Protection strategy and Financial Risk Outlook, both in 2010. They identified complaint handling as an area of significant detriment and likely resource reduction as firms looked to shore up their capital base. In order to prove the scale of the detriment the FSA looked at a significant number of files of the major banks and insurers to make an assessment of their complaint handling. Following that exercise, the FSA has undertaken a thorough work plan around improving complaint handling, redress, mass claims, enforcement for breaches to its DISP, and how complaint handling can feed into regulation. The work taken to discover firms" poor practices was quite clearly extensive.

It is quite unlikely the FCA will have the necessary resources to be able to devote to each product to investigate whether there needs to be early intervention.

The analysis that proved poor complaint handling was based on historic evidence – on complaint files, recorded timelines and advice. Judgements made on the basis of predicting and preventing detriment are clearly less empirical. In financial services, detriment may only be revealed well into the product life cycle and, in addition, a product may be toxic for some customers but not others. If the evidence burden were to remain as high then it is likely the process would be too long and acceptable evidence too narrow to deliberate on important factors that the FCA should use to inform its judgement. This will be particularly difficult considering the FCA"s expanded work plan.

We would like clarification on consumer and consumer groups" involvement in the provision of evidence, and what matrix will be used. We believe there is the duel danger of the FCA"s resources being tied up in proving governance processes cannot be first amended to remedy the problem and also in firms" gaming these measures, thus we could see large resources could committed for little return.

We do not believe product intervention as currently framed is likely to restore consumer confidence in the regulator since we do not believe it will be sufficient to make products suitable. We believe more forceful and preventative measures are necessary to restore trust.

We would like to propose a radical alteration from the discussion paper. The product intervention paper is quite explicit – the FSA does not plan to give product pre-approval. It identifies significant dangers in that approach. For the regulator it would be too resource intensive. There are dangers in giving products an FSA seal of approval and it may not be best placed to design products.

All the above makes the case for a separate mechanism to ensure consumer products have been pre-tested to remove any toxicity. Consumer Focus recently produced a discussion paper in association with the National Consumer Federation to look at how best products and services could be designed regulated and monitored to ensure customers are treated fairly and market competition leads to productive competition.[10] This paper identifies how a framework of principles-based regulation can work alongside specific product steering groups to produce standards.

The paper borrows concepts that are used in product design from manufacturing and service delivery industries. It also allows consumers and consumer groups across the country to input into both the design and enforcement of standards. Flexible working

[10] Consumer Focus, Fair enough **http://consumerfocus.org.uk/g/4ox**

groups could also adapt how the principles of fairness apply over time as market dynamics and technology evolves.

This could be done with an FCA approved standards committee for differing products. On such committees consumers and consumer groups could play some role in defining what is an acceptable and fair product in each market place prior to the FSA intervening. This could restore consumer trust and bring confidence in the regulator by enforcement directly being linked to consumer"s expressed concerns.

If the focus was transferred to the end result – the product – it would save firms huge sums in compliance costs. Secondly, if product design intervention through standards preceded the regulator"s intervention it would ensure appropriate products were designed with clear guidance to the regulator about what product was acceptable.

14. The Government would welcome specific comments on:

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

Transparency and disclosure: Transparency will be essential for the FCA in the exercise of its functions. Consumer confidence as well as consumer protection is enhanced by the openness of the regulator. The regulator should be open in its investigations and regulatory activity and therefore accountable. Reputational regulation may, in itself, help develop a trusted brand approach in the industry. We have previously been highly critical of the FSA"s opinion that they are unable to disclose early information about enforcement action and the compliance records of firms. Therefore, we very much support the Government"s proposals to legislate to give the FCA additional powers of disclosure, which we hope will resolve this issue. A culture of publishing and analysing compliance, complaints and enforcement actions to identify emerging risk and as a window on the industry is vital. It is also central to developing a wider understanding of the role of the regulator.

It is important that the FCA provides consumers with usable information on numbers of complaints made to banks about their products and service. For the six month reporting period of January to June 2010, consumers of financial products and services made 1.8 million complaints[11].

The FSA and FOS are rightly trying to improve consumers" understanding of which firms are committed to giving good customer service by publishing complaints data.

We hope complaints data can become a productive way to differentiate brands. Complaints data can give consumers an informed opinion about which firms are customer service orientated, trustworthy and able to deal with complaints effectively.

It is early days in the publication of complaints data as part of the FSA"s approach of transparency as a regulatory tool. Currently we have certain difficulties with the publication of the data, most notably the data:

- does not differentiate between banking products (within the banking and credit category);
- gives no indication of market share so it is difficult to assess how good or bad the bank is proportionately to their customer base

[11] http://www.consumerfocus.org.uk/news/consumer-focus-response-to-fsa-complaints-published-today

- fails to capture complaints resolved at 4 weeks
- fails to show how many complaints are resolved within the end of the business day

This aspect of qualitative assessment, based on brands actual performance in generating/avoiding complaints on specific products can be enhanced greatly.

We are unclear whether changes to the Financial Services and Markets Act would be necessary to enact such changes. In the interests of consumer empowerment any necessary legislation should be enacted to facilitate customer choice so that consumers can discipline the market by being able to make judgements of a firms‟ commitment to complaint handling and customer service.

Financial promotions: We support the FCA‟s new power to direct a firm to withdraw or amend misleading financial promotions with immediate effect and to publish that it has done so. This will reduce the potential consumer detriment as a result of such promotions and improve consumer confidence in the ability of the FCA to take effective action in appropriate circumstances.

Warning notices: This represents a key change in approach on the part of the regulator. As stated above, this is an area where the FSA has refused to provide any information in the past. We are very supportive of this strengthening of the current position, but note that it will not be a duty, but rather an expectation to be exercised at the discretion of the regulator. While we appreciate the need for fairness towards affected firms and individuals, the regulator should balance the impact on the subject of the notice with the potential detriment to consumers. In these situations, the consumer interest should take priority. Accordingly, there should be a regulatory presumption for the publication of a warning notice, apart from in exceptional circumstances specified within the legislation. Furthermore, where enforcement action has been upheld and no warning notice was published, an explanation of why the regulator exercised their discretion not to publish the notice should be provided. In addition, if it is decided at the outset of enforcement proceedings that the warning notice should not be made public, there should be an ongoing duty to continue to weigh the firm or individual‟s interests against those of consumers with regard to public notification of the enforcement process.

15. Additional powers in relation to general competition law

It is important that market failure is addressed promptly by the regulator and the current model of prompt analysis and recommendation provided by the super-complaint process operated by the OFT should be extended to the FCA. Power to bring a super-complaint to the FCA should be granted not only to the Consumer Panel but also other bodies such as our successor body Citizens‟ Advice and Which?.

The Consumer Panel would benefit from powers to request information from providers in order to carry out its statutory functions. Such a power would ensure that it was able to make an independent assessment of failure in the market and the extent to which any corrective action is likely to protect consumers from future detriment.

The FCA should have powers with regard to market investigation and review as it not clear that these will be retained by the OFT or its successor body following the changes in the competition and consumer landscape being considered by the Government[12].

Questions 17 and 18: Co-ordination between the PRA and FCA, and the veto

The twin peaks structure proposed, in recognising the fundamental difference between prudential regulation and conduct of business regulation and in giving regulators clear

[12] BIS consultation “A Competition Regime For Growth”.

objectives, promises to overcome some of the problems in the current single regulator system. The challenge will be co-ordinating the views of the different agencies and resolving conflict.

The foundation for this structure should be clear public policy objectives and accountabilities. Our experience across different sectors is that the high-level objectives of Government are rarely fully articulated, even in statutes, with the result that decisions can too often be made on the basis of inter-organisational politics and individual regulators' preferences and cultures.

The need to coordinate and consult between the PRA and FCA must not lead to undue delay in taking action that would prevent more consumers experiencing financial harm with the negative impacts this can have on consumers" ability to provide for themselves and their families.

The measures outlined in the consultation paper are welcome, in particular the cross membership of Boards. However there remain concerns that the FCA will not be an equal partner as its decisions can be vetoed by the PRA.

While we accept that there may be exceptional circumstances where a veto on an FCA activity might be needed we believe that any use of the veto should be regarded as likely to have arisen from the failure of the PRA or FCA or both to achieve their objectives. Any use of the veto should lead to an inquiry of what went wrong. The presumption must be that the results of the inquiry must be made available not only immediately to the Treasury Select committee but also to the public within an appropriate timescale.

Given that there are mechanisms where the PRA and FCA can work together to consult and agree on a course of action any resort to a veto would be likely to occur in a scenario whereby the FCA believes that without action a group of consumers face ongoing detriment. The consultation document states that in some circumstances the PRA may need to use its veto to prevent a disorderly failure with possible systemic stability consequences. We consider that the definition of what would have systemic stability consequences must be extremely narrow to avoid undue pressure on the FCA and/or the PRA not to take much needed action against firms.

The ongoing need for such measures will depend in part on the outcome of the Independent Commission on Banking"s report into how to protect our economy and banking system and promote competition after the calamities that occurred in the crisis of 2008. It is vitally important that a robust and diverse financial system is created thus lessening the need for future intervention.

Regulatory processes and co-ordination

21. What are your views on the Government"s proposals for the approved person regime under the new regulatory architecture?

We understand why dual regulation will give rise to dual powers in relation to approved persons in certain firms, but it is a complicated arrangement.

In addition, the paper does not explain how the approved persons regime will be applied to the consumer credit businesses transferring from the OFT and how this will be resourced. As stated above, an increase in fees, in order to support the higher level of scrutiny from the FCA, could lead to costs being passed on to the consumer and may not be sustainable for smaller credit businesses. This could prevent new businesses entering the market, including community-based projects.

23. What are your views on the Government"s proposals on the treatment of treatment mutual organisations?

We welcome the Government"s recognition that regulatory costs for mutuals such as credit unions and friendly society must be monitored. We wish to see diversity in the banking system and believe that regulatory costs should be proportionate to their size and risk.

28. Views on proposals for powers in respect of fees and levies

There is a huge difference between the typical fees paid under the current FSA and OFT regimes, and the period over which they apply. A move to a FSMA-based regime has the potential to result in a significant increase in fees for many firms. We support the Government"s approach, as set out in its consultation on changes to the Consumer Credit Regime, that, in setting fee levels for authorised credit providers, the FCA will ensure proportionality and consider the appropriate level for minimum fee requirements for different types of business.

Consumer Focus wishes to see a healthy, competitive marketplace in credit encouraged. Well run small businesses, and other small players such as credit unions, microfinance schemes and co-ops providing a wide choice of products, services should be actively encouraged to form part of the credit market. We would not want to see these types of organisations excluded from the market by the fee regime.

FOS and transparency

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

Too many complaints are being referred to the FOS by consumers dissatisfied with the response they have received from their provider. The FOS says it settles over 150,000 complaints each year[13]. For the year 2009/10 the FOS upheld 50% of the disputes it investigated[14].The high upheld rate by the FOS on consumer complaints is evidence that the high number of complaints is a result of firms not dealing properly with the complaints they receive by ensuring where they are at fault they put things right and provide adequate redress.

We welcome the clarification on the FOS"s ability to publish information including its determinations. We believe this should include the publication of the names of firms that are involved in the detriment as this will allow consumers to have the confidence to seek redress (see box below.) The FCA should step in promptly in response to information gathered by the FOS of unfair behaviour by financial providers. Early intervention by the FCA will be needed to curtail detriment and prevent consumers needing to embark on a lengthy process to get redress for practices that the FOS as identified as unfair. This

[13] http://www.financial-ombudsman.org.uk/about/index.html

[14] http://www.financial-ombudsman.org.uk/publications/ar10/dealt.html#ar3b

should link it with the FCA approach to product intervention which we commented on earlier in this response.

In a recent case involving Clydesdale Banks[15] the bank revealed it had failed to accurately calculate interest rates for some of its variable and tracker mortgage holders, meaning minimum repayments were set at too low a level. The bank apologised for the error but still sought to recoup the resulting shortfalls by increasing payments. Reports suggest that this might have added over a hundred pounds to some customers' monthly bills.

Clydesdale Bank continued to take these retrospective payments despite clear indications from the FOS that consumers shouldn't be held responsible for errors of this type. FOS publicly clarified its approach in September, leaving no room for confusion. Consumer Focus has written to the FSA calling for action because Clydesdale Bank should take into account the FOS's decisions and its approach on mortgage underfunding. Instead the bank has continued to levy higher payments and not compensate customers who complained, leaving them with little option but to pursue the issue with the FOS.

FOS data published this week showed that in the second half of last year complaints from Clydesdale Bank customers about mortgages increased by more than 600 per cent on figures from January to June 2010. Clydesdale Bank mortgage customers who have taken their case to the Ombudsman have had their complaint upheld in 87 per cent of cases, against an industry average of 36 per cent.

Customers report receiving thousands of pounds back from the bank after the Ombudsman ruled in their favour. However the FOS did not name the bank concerned meaning that only tenacious and/or well-informed consumers got full recompense.

[15] http://www.consumerfocus.org.uk/news/consumer-champion-calls-on-clydesdale-and-yorkshire-bank-to-do-the-right-thing-by-its-mortgage-customers

Compensation, dispute resolution and financial education

31. What are your views on the proposed arrangements for strengthened accountability for the (Financial Services Compensation Scheme) FSCS, Financial Ombudsman Service (FOS) and Consumer Financial Education Body[16] (CFEB)?

We agree that the publication of, and consultation about, their annual reports by FSCS and FOS should be put on a statutory footing, but we consider that accountability must also include engagement with consumers. We believe that each of these organisations (ie including CFEB/Money Advice Service) should also be required to produce an annual consumer engagement strategy.

The process of consultation carried out by CFEB, now Money Advice Service (MAS), in relation to its annual plan, was not designed to achieve engagement with consumers. For example, the draft plan was not on the CFEB website for comment. We consider that in its new formation as MAS, the organisation should pay greater regard to being accountable to consumers and seeking out their views.

The previous section proposes that the law will be clarified, so that the FOS will be able to publish information about its determinations. This should raise its profile with consumers, who will recognise it as an organisation able to hold the financial services industry to account. Concrete examples of dealing with poor performance on the part of financial services bodies will give it increased credibility among the public.

We are aware of the efforts the FOS has made to strengthen its relationship with on-the-ground advisers and to improve its recognition within local communities. We would like to see the MAS take similar steps to engage with consumers. The suggestions elsewhere in this response on consumer engagement may also prove relevant.

[16] Renamed the Money Advice Service, as of 4 April 2011

Consumer Focus response to HMT consultation on a new approach to financial regualtion: building a stronger system

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A new approach to financial regulation: building a stronger system

Response by the Council of Mortgage Lenders to HM Treasury's consultation paper

Introduction

1. The CML is the representative trade body for the first charge residential mortgage lending industry, which includes banks, building societies and specialist lenders. Our 109 members currently hold around 94% of the assets of the UK mortgage market. In addition to lending for home-ownership, the CML's members also lend to support the social housing and private rental markets.

2. We welcome the opportunity to respond to the Treasury's latest consultation on the reform of financial regulation. We issued a brief response to the consultation on 'judgement, focus and stability' in which we warned against hasty regulatory reform that could be considered reactionary, lacking sufficient oversight and to the detriment of the market.

3. The CML's response to this consultation has been shaped by our experiences of the FSA's Mortgage Market Review (MMR), which has been one of the key regulatory initiatives designed to address previous market and regulatory failings. As not all of the consultation questions are directly relevant to the CML, or the home finance activities of our members, we have focussed our response on areas of particular interest across each of the main chapters in the consultation paper.

Executive summary

4. We continue to recognise the potential benefits of separate prudential and conduct regulation. But there are real risks that the desired outcomes will not be achieved. For the new structure to prove effective, it needs to be coordinated, proportionate and evidence-based regulation targeted at current or emerging prudential and conduct risks, rather than retrospective action designed to solve problems of the past.

5. We are pleased to note that the government has listened and acted upon a number of the concerns raised by the industry and the Treasury Committee. The renaming of the proposed Consumer Protection and Markets Authority (CPMA) to the Financial Conduct Authority (FCA) is helpful, as is the re-affirmation of the regulatory principle that consumers should be responsible for their own decisions.

6. Financial stability is a fundamental objective, but it must not be pursued without due regard for fostering competitiveness as well as cross-market, cross-border and socio-economic issues. It is clear that both regulators will need to strike a careful balancing act between proportionality, as per the proposed regulatory principles, and pro-active interventionism. The practicalities of how this will work in every conceivable instance are impossible to legislate for now, but we are deeply concerned that, having placed so much stake on more robust regulation and new tools, the regulator might be under internal and external pressure to use them excessively.

7. Layering of regulation, as we have seen with prudential regulation of mortgage lending followed by conduct regulation through the MMR, would lead to the wrong outcomes. Two contradictory approaches to regulation from prudential and conduct regulators creates similar risks – we have already seen a tangible example with different messages from the FSA on the pros and cons of forbearance for mortgage borrowers in arrears. Close liaison and complementary approaches will be vital but there has been a chequered history of this in the past considering how the Office of Fair Trading and FSA have co-regulated secured loans.

8. This risk is particularly relevant looking forward given that the proposed statutory safeguards on the deployment of the new macro-prudential and product intervention tools could prove insufficient. We would argue that robust impact analysis must be published and consulted on before these new, and largely untested, regulatory tools are used. It is also vital that the impacts of new provisions are

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assessed in totality with existing national and international regulations to avoid a detriment to businesses in the UK.

9. We would support a judgement-led approach by the Prudential Regulation Authority (PRA), provided that it is evidence-based, and adheres to a transparent process.

10. Similarly, we understand the government's desire to move towards conduct regulation that manages down the appetite for risk. However, this should be different to risk aversion. The proposals, as framed, risk unintentionally veering towards the 'zero-failure' approach that the government wishes to avoid. Disproportionate use of product intervention and a lack of granularity in the regulator's understanding of retail consumers might see tools designed for high risk exceptions instead being used as a one size fits all approach. We welcome that the FSA has insisted that this is not its intent on the MMR, in its commentary in the business plan, but the consultation proposals as drafted do not reflect this policy.

11. We wait with interest to see the detail within the draft Bill and to understand how these practicalities will play out in the transition period and after restructuring of the FSA into separate parts.

12. But, we believe there are some important factors that need to be given due consideration sooner rather than later, particularly in the context of coordination and cost-effectiveness. There is a risk that much of this is being left to individual interpretation through loosely drafted Memoranda of Understanding.

13. We believe that there is merit in establishing Practitioner, Smaller Business Practitioner, Markets and Consumer Panels that overarch both regulators to help ensure that the cumulative impacts of prudential and conduct regulation are assessed at market, regulated firm and consumer levels. Without more robust processes to ensure coordination, and clear statute backed expectations of when the regulators are expected to consult firms and consumers, firms are likely to face duplication of effort, significantly higher costs and potentially conflicting regulatory and supervisory requirements.

Bank of England and Financial Policy Committee

14. We believe that there is merit in establishing the Financial Policy Committee (FPC) within the Bank of England and reinforcing this relationship through the alignment of an overarching objective to maintain financial stability, as proposed in the paper. The government is also right to recognise that decisions taken by the FPC could have far reaching effects on consumers, the financial sector and the economy as a whole.

15. It is for this reason that we wish to see the FPC exercise greater caution and consider more formal, robust, transparent assessments of the market impacts prior to deploying its proposed macro-economic tools. Of particular concern is the ability to impose macro-level loan-to-value (LTV) or loan-to-income (LTI) caps, without prior consultation or a full impact assessment.

16. The proposed summary of how the FPC's objective is expected to link into that of the Bank references how the FPC will "[not be required or authorised] to exercise its functions in a way that would in its opinion be likely to have a significant adverse effect on the capacity of the financial sector to contribute to the growth of the UK economy in the medium or long term."

17. While helpful to state in the statutory obligations of the FPC, it is unlikely that this requirement will have a material effect on how the FPC will exercise its function and, more importantly, the impact of those functions. We believe that the risk of adverse market impacts is far more likely to result from unintended or ill-considered consequences rather than a conscious decision.

18. We welcome the government's recognition that the FPC should have secondary factors to consider in accounting for the wider impacts of its work. We are particularly encouraged to see that the government proposes to legislate for 'proportionality' and 'openness', two key principles of effective regulation, as part of these secondary factors.

19. It is therefore disappointing to note that, in its analysis of proportionality, the government does not intend for the FPC to produce formal cost-benefit analyses in order to address and mitigate

unintended consequences. Although cost-benefit analyses for macro-prudential tools will be particularly difficult to quantify and make concrete, we believe that they are a necessary component in giving confidence to the industry and determining whether largely untested macro-prudential tools will deliver the intended outcomes and, if so, at what cost to individual firms, consumers directly or indirectly, and the market as a whole. For example, the introduction of LTV or LTI caps will disadvantage existing borrowers who would no longer qualify for a loan because the lending limits have been changed - a feature which is already prevalent in the market as a result of the FSA's supervisory approach to de-risking in the last few years.

20. In response to **question 1** on macro-prudential tools, it is unclear whether, for example, a blunt instrument such as an LTV or LTI cap imposed as a remedial measure would be needed in light of the regulatory reaction, both nationally and internationally, following the financial crisis.

21. Capital requirements under the Basel regime now mean that lenders have to hold significantly higher amounts of capital for higher LTV loans. From a conduct perspective, the FSA is considering how lending criteria and underwriting practices might be strengthened – although still under consultation - lenders have already moved away from specific products, such as self-certification, as well as those combining a mix of high-risk elements.

22. We are concerned that the deployment of macro-economic tools in the current market will deliver no discernible benefit, and could instead restrict access and reduce choice for the majority of consumers. It is particularly disappointing to note that the FPC will not be expressly required to publish a policy statement in advance, setting out how it plans to employ each tool and the circumstances in which they might be used.

23. The lack of formal cost-benefit analysis is of further concern when considering the government's intention to legislate to provide the FPC with powers of 'recommendation' and 'direction' over the PRA and FCA. We note that the FPC will be allowed to 'recommend any action it believes necessary to protect or enhance financial stability'.

24. As the Treasury Committee noted in its preliminary consideration of the government's proposals, predicting financial stability may be hard to define in practice. Regulators will need to pay close to attention to how national macro-prudential tools will interact with both national and international provisions, as well as the activities of regulated firms in other jurisdictions.

25. We would argue that any 'recommendation' or 'direction' should be subject to consultation and a full cost-benefit analysis comprising cross-market impacts, particularly as macro-prudential tools will be medium-term risk mitigation rather than emergency solutions. In the context of mortgage lending related provisions, we would like to see this consider wider housing and socio-economic factors, as well as any potential conduct or contractual issues, for example existing borrowers with LTV or LTI ratios that exceed the cap may have flexible or drawdown arrangements nullified in their contracts.

26. Paragraph 2.30 of the consultation paper proposed 'public pronouncements and warnings'. It is unclear whether these will relate to potential or crystallised risk, or will require action by firms.

Prudential Regulation Authority

27. There appears to be a missing link from the PRA's strategic objective, which focuses on the promotion of stability of the UK financial system, to its operational objective, which is to promote the safety and soundness of PRA authorised persons.

28. In response to **question 5**, we believe that the operational objective should be more tied into the supervision of firms, particularly as the PRA will have the capacity to authorise and supervise those firms. Supervision of authorised persons should instead be more of a supporting function of regulating those firms.

29. We believe there is also merit in including competitiveness as an objective of both the PRA and FCA to ensure that the strategic objective of promoting financial stability is discharged responsibly and without adverse effect on the competitiveness of individual markets or the UK as a whole.

30. We welcome the government's proposed simplification of the 'have regards' by encapsulating them within a set of regulatory principles that would apply equally to the PRA and FCA. We would support these principles being enshrined in legislation to ensure that they are given due prominence in both regulators' day-to-day activities.

31. We are encouraged that the government has included a general principle across both regulators that consumers should continue to take responsibility for their decisions, a vital tenet of responsible lending and a necessary balance to the 'consumer protection' interests of the FCA. However, we would prefer the wording of this principle to be amended to 'ultimately responsible' as per paragraph 1.25 of the paper, subject of course to firms adhering to existing conduct of business rules.

32. We are encouraged by the inclusion of a cost-efficiency principle, the adherence to which will need to be carefully co-ordinated across both the PRA and FCA. Though we note and support that the government will legislate for both regulators to have a statutory duty to coordinate, we believe that is a missed opportunity not to include effective coordination as a regulatory principle.

33. The government is right to highlight the importance of competition, diversity and innovation. We understand the reservations that the government might have in a regulator facilitating innovation, and that it should instead focus on developing a regulatory environment in which innovation can deliver desirable outcomes. We have doubts as to whether the increasing focus on product intervention on one hand and prescriptive rules on the other, will foster that regulatory environment. We cover this in more detail below.

34. In response to **question 7**, the concept of a judgment-led approach is a sound one, provided that it is evidence based, independent and not subject to external political and media pressures. It will also be necessary for judgements to be consistent, albeit not precedent setting, and undertaken by sufficiently senior and knowledgeable staff with appropriate governance oversight. Given how ill-considered proactive intervention could undermine consumer and market confidence, we would prefer these judgement-led decisions to be based on a tightly managed scorecard of influential factors.

35. One area of concern in relation to rule-making is the proposal that the PRA will not only enforce its rules but compliance with the 'spirit' of those rules. The justification for this is given as 'to tackle attempts by firms to circumvent the intended purpose of a rule while still complying with its specific requirements'.

36. It is difficult to understand under what circumstances a firm could be complying with specific rules yet failing to adhere to the spirit, particularly in an environment of increasingly prescriptive and less principles-based regulation. We would contest that rules which can be complied with, yet enable the regulator to draw the conclusion that the firm is flouting the spirit, are not fit for purpose.

37. In response to **question 10**, we welcome the government's proposal to largely retain the requirements within the Financial Services and Markets Act 2000 (FSMA) regarding the PRA's consultation on its own rules. We also support the view that the new regulator must be rigorous in its impact assessments. We agree that proportionality should be more tightly defined, but would argue that a fully quantified cost-benefit analysis should be the default starting position for any rules-based consultation.

38. We support the intention to maintain consultation with practitioners, at the very least along the lines of the current FSA Practitioner Panel. There is a strong argument for not only retaining the current Panel structure, but broadening the Panels across both regulators to act as a safeguard and sense-check in preventing unintended cumulative impacts of layering prudential and conduct regulation.

Conduct regulation

39. The CML has taken a prominent role in responding to the FSA's Mortgage Market Review. This workstream has been a cornerstone of the FSA's move towards a new approach to conduct regulation with more intensive scrutiny of regulated firms, their products, the information they provide to consumers, and the risks these might pose.

40. As detailed in our responses to the FSA's discussion and consultation papers on this subject, we believe that, although based on well-meaning intentions, there are a number of risks with the FSA's approach.

41. In a desire to reduce "conduct risk", we do not believe that the FSA has given full consideration to the broader social, economic, political and regulatory implications. Mitigating conduct risk in the home finance market by restricting access, for example, does not address the question of where consumers will live if they are unable to become homeowners in the future.

42. In response to **question 11**, we believe that these risks could further manifest themselves in the proposed functioning of the FCA. As covered in our comments on the PRA's objectives, above, the FCA's strategic and operational objectives do not give due prominence to the wider impacts, including competitiveness, that need to be considered if the new approach to conduct regulation is to benefit markets as a whole, as opposed to enshrining risk aversion.

43. Although helpful that the government has issued some clarification on the FCA's role as 'consumer champion', we would prefer that this term is not used at all. It could be too easy for some areas of the media and consumer groups to latch onto this term, building unhelpful expectations among consumers. It would be more appropriate for the FCA to independently champion markets that are sustainable and flexible for all participants.

44. We support the government's intention for consumers to retain responsibility for their own decisions. But, for this regulatory principle to be upheld, the regulator will need to have a clear understanding of the discreet differences between consumers' behaviours, capabilities and product choices – and therefore the extent to which they require regulatory protection. Our consumer research to inform our response to the MMR has shown a dislocation between consumers' views and the regulatory approach.

45. In keeping with another of its regulatory principles, the FCA will rightly need to be proportionate in its protection of consumers' interests. However, in citing different approaches for consumers in the retail and professional markets, the consultation merely points to different types of consumer between these markets rather than equally important differences within them.

46. We would prefer a more nuanced, granular approach to be paid to proportionality. If, as can be inferred from the consultation paper, all retail consumers are deemed by the regulator to be requiring broadly the same level of protection, be it through product intervention or disclosure, this is likely to be drawn along very restrictive, one size fits all lines.

47. Although this will have the most vulnerable consumers in mind, and offer them an appropriate level of protection, it would at the same time exclude or limit the flexibility of a higher proportion of more capable and informed consumers. The Policis consumer research for the CML on the MMR and our own analysis of mortgage market data shows this to be a significant issue, which the FSA now seems to accept based on its business plan.

48. We have raised similar concerns in our response to the FSA's recent MMR consultation paper on distribution and disclosure, highlighting the risks of a single standard for both advised and non-advised sales processes.

49. Unless the FCA targets its more rigorous conduct regulation strategy more carefully, it risks unreasonably undermining its requirement to promote competition and thereby restricting consumer choice.

50. In response to **question 12**, we support the intended governance structure, although we cover coordination across regulators below. Similarly, we fully support the roles of the Practitioner, Smaller Business Practitioner, Markets and Consumer Panels being enshrined in the legislation.

51. Looking at the FCA's new approach to conduct regulation, we believe that more careful thought needs to be given to how pro-active regulation can be balanced with the FCA's regulatory principle to be proportionate, and how intervention, particularly at a product level, might unintentionally stifle innovation. This is an issue which will be covered in our separate submission to the FSA on its recent Discussion Paper 11/1 on product intervention.

52. We have already seen the FSA move away from being a principles based regulator to one focussed on outcomes. We agree that routine supervision of individual firms' conduct of business is a necessary element of a more intensive, intrusive supervision, provided that it is properly targeted and the requirements on firms are explained in advance.

53. 'Issues based' supervision, as proposed in the paper, would naturally be a more difficult process to manage, incorporating individual reviews across a number (if not all) firms that offer a product or operate a process. This cross-cutting approach raises concerns over the consistency of individual supervisor's opinions and interpretations across firms, a concern that we have identified with the current regulatory Mortgage Conduct of Business (MCOB) regime.

54. Regardless of whether intrusive supervision is at a firm or issue level, it requires a rule set that provides firms with certainty and clarity of what the regulator expects. We believe that this has been a failing of the FSA as it has moved towards more intensive, outcomes-focused regulation with a rulebook that is still largely principles based.

55. The new product intervention powers are of significant concern.

56. The FSA's Discussion Paper on product intervention (DP 11/1) outlines a range of different options and levels of product intervention that could be used to mitigate the risk of consumer detriment before it crystallises. Some of these options are ruled out by the FSA, for example product sign off by the regulator would require significant resource and could create a false sense of security or moral hazard. However, the broad set of options that remains is likely to result in a risk averse approach by lenders in the products they seek to develop, due to uncertainty as to whether the regulator will intervene or not after launch.

57. Where innovation does occur, it is likely to be undertaken by larger firms that have the resource to fully test and research the relevant consumer group it is targeting, the impact of the product on that group and the risks of different distribution strategies (e.g. intermediated business may be deemed too risky due to the lack of control). This will clearly have an impact on competition and diversity within the market, as small firms have been innovators in the past.

58. With few details in the consultation paper on how these powers might be deployed, and under what circumstances, we welcome the government's intention to consult on a set of governing principles. It is crucial that these governing principles are developed and come into being prior to the powers themselves. Without these principles and clear parameters for when product intervention would be appropriate, there is a risk that the FCA could use these new powers disproportionately to show that it has teeth – particularly given the move towards a more proactive and intensive approach to regulation.

59. We would go further and propose that the FCA should publish and consult on a robust cost benefit analysis before determining whether an individual instance of product intervention is appropriate. This should include a clear illustration of the number of consumers have suffered (or are likely to suffer) detriment against the total number that have taken out (or might take out) the product.

60. We believe that product intervention should only be considered in exceptional cases, and where there is a clear systemic evidence base of that product (or, if the intervention is being deployed pre-emptively, a product exhibiting clearly similar characteristics and in similar market conditions) being the direct cause of consumer detriment.

61. It should not be used as a tool to mitigate risk if the vast majority of consumers are likely to benefit from or not suffer detriment from the product. The FCA will have other existing regulatory tools to impose targeted conditions or controls around particular products where this is the case.

62. The government's intention to legislate for the FCA to make provision on the unenforceability of contracts made in breach of product interventions is an appropriate principle, but will hinge on clear and prescriptive statements from the regulator on what products (or elements of products, including contract terms) have been banned and between what dates to avoid confusion or shifting regulatory interpretation.

63. We note that the FCA will be able to draw on wider sources of intelligence in indentifying risk, including information provided by the Financial Ombudsman Service. We would prefer the FCA to use robust regulatory information in determining whether product intervention is appropriate, rather than drawing potentially misleading, generalised conclusions from a few specific Ombudsman decisions.

64. DP11/1 points to Ombudsman decisions as a cause for the regulator to consider product intervention. We are concerned that using Ombudsman decisions as a prompt for product-level regulatory scrutiny will merely become a self-fulfilling prophecy as that scrutiny will in turn instigate further complaints (whether valid or not), particularly from claims management companies.

65. Further to this point, and in response to **question 14**, we are deeply concerned that the government intends to legislate to allow both the PRA and FCA to publish that a warning notice has been issued against a particular firm. Raising public awareness that a firm has entered the enforcement process and prior to any final decision will be disproportionately damaging, not only to the firm, but also possibly to the reputation of the sector of the financial services industry.

66. This power could add fuel to the fire for claims management companies and consumer campaigns, despite the fact that the regulator may not complete an enforcement case successfully. We believe that enforcement action should only be published once the enforcement action has completed and any subsequent findings, undertakings and levels of consumer can be factually described.

67. In other topics covered in this chapter, we note that the FCA will have regard to financial crime, and we would support this regulatory involvement, as we have previously with the FSA. We would welcome continuation of the Information from Lenders (IFL) scheme, which allows lenders to notify the FSA of suspicious activity by brokers.

Regulatory processes and coordination

68. As highlighted in our response to the government's previous consultation, for twin peaks regulation to prove effective there must be structured coordination and constructive dialogue between both regulators. In response to **question 17**, we welcome the government's decision to introduce new legislative provisions to establish coordination mechanisms and for there to be a statutory duty to coordinate.

69. We agree that these mechanisms should establish the framework within which cooperation should take place, rather than specify prescriptive, bureaucratic processes. But we are concerned that the three main limbs of the statutory duty will fail to establish broad parameters for circumstances in which the PRA and FCA must coordinate their efforts and consult each other. The danger is that this will be left open to individuals' interpretation and will only be used rarely.

70. The importance of coordination across the new regulatory structure can not be stressed enough and is something that cannot be left to chance. Paragraph 2.111 of the consultation paper states: "The Government anticipates a close and constant working relationship between officials in the Bank and the PRA, with changes to the regulatory architecture driving a new culture of cooperation." We believe that more formalised processes and expectations of when the regulators will cooperate should drive this culture, rather than the transition to the new structure itself.

71. Although both the creation of a Memorandum of Understanding (MoU) and a duty to coordinate are both being legislated for, we are unconvinced that one will necessarily support the other. We would argue that the MoU risks becoming a peripheral document that will not be a consideration at the heart of both regulators' day-to-day operational work.

72. In addition, the paper does not fully address perhaps the most important element of how the new regulatory structure will be coordinated – that is how regulated firms are expected to interpret potentially conflicting regulatory stances adopted by the PRA and FCA. Our members are already experiencing difficulty, for example, in marrying views from the conduct and prudential arms of the FSA on the treatment of mortgage borrowers in arrears.

73. Government, the courts, advice agencies and borrowers themselves have particular expectations of what lenders can do to help borrowers experiencing payment difficulties since the financial crisis. These pressures, along with the recently bolstered FSA Handbook conduct of business rules (MCOB 13), and the mortgage pre-action protocol, have ensured that lenders only seek possession as a last resort. Lender forbearance has correctly been cited as a significant factor in keeping the number of possessions below anticipated levels since the financial crisis.

74. The FSA's Prudential Risk Outlook published earlier this month argues that lenders have been applying 'excessive forbearance' which may be 'disguising the scale of the problem'. It cites both low interest rates and low unemployment as the main factors behind possessions remaining low, but gives little recognition to the conduct regulation and other pressures that lenders have been under to show forbearance.

75. We are concerned that, without effective coordination under the new regime and, where appropriate, the development of a balanced, single regulatory position on certain issues, firms will not have sufficient certainty to comply with both regulators' expectations.

76. This is unlikely to be an issue on which the veto would be used, and nor would it necessarily be appropriate. We would prefer to see something in the MoU to cover how both regulators would resolve different views that could be construed by firms as potentially conflicting expectations, which could be further aided by a single rules Handbook.

77. We would also urge the government to place obligations within the MoU for the PRA and FPC to consult each other in advance of drawing up thematic reviews or supervisory visits to individual firms. It is also crucial that the need for regulatory information from firms is made clear and duplication is eliminated wherever possible through a common gateway.

78. In response to **question 18**, we support the government's intention to lay notification of the veto before Parliament, subject to considerations of public interest, including financial stability and confidentiality. We would also support the PRA's annual reporting on the use of this power.

79. Although we appreciate that the PRA is unlikely to exercise its power of veto widely, the very fact that it exists does call into question the assertion in paragraph 5.6 of the consultation paper, that the PRA and FCA will be 'equal in status'.

80. In responding to **questions 19, 20 and 21** we appreciate that much of the detail on regulatory processes and cooperation will only be published in the Spring, but there are a number of areas that we believe need close attention.

81. There is a risk that dual-regulated firms will face duplicated effort and costs, as well as inconsistent regulatory approaches and processes.

82. The move towards a twin peaks approach to regulation does not negate the need for shared services, particularly in relation to back-office support functions. Not only will it help both regulators adhere to their 'efficiency' principle, but it will also give firms confidence in broad uniformity of the regulatory process.

83. We are encouraged that the government has presented two options for the authorisation process. Regardless of which is chosen, there should be a single gateway for firms to access the authorisation process, that does not present new delays as a result of the 'twin peaks' approval and with clear information requirements on firms. For these reasons, we would lean towards the 'alternative approach' outlined in the paper.

84. On approved persons, we agree that there should be a broad split between the roles of the PRA and FCA, with the PRA authorising all individuals wishing to take on a Significant Influence Function. We note that both regulators will have the power to specify new controlled functions. We hope that this is not an indication that either regulator will be looking to introduce new controlled functions without paying due regard to the functions that already exist to strengthen both conduct and prudential regulation.

85. In response to **question 23**, we would support any efforts to estimate the impact of regulatory proposals on mutuals within robust, published cost benefit analyses that are open to consultation, in order to preserve a diverse market that facilitates both competition and innovation.

86. In response to **question 24**, we would support the retention of a single regulatory Handbook. This would deliver benefits for both regulators and firms, in understanding how prudential and conduct regulation inter-relates and establishing coherent regulatory expectations.

87. As highlighted in our response to the FSA's MMR consultations we would welcome rules that are clearly drafted, aligned to policy intentions and give firms regulatory certainty in an environment of intrusive supervision. Such rules are necessary to prevent retrospective interpretation and support the new approach to conduct regulation.

88. We note that the government considers it important that the PRA and FCA consult each other prior to establishing new rules. While this may be beneficial in understanding the cross-regulatory implications at an individual rule level, this would not necessarily give true consideration of the totality.

89. We would prefer the establishment of a cross-regulatory steering group to maintain ownership and oversight of the single Handbook to better assess the totality of any new amendments, in addition to statutory coordination across the PRA and FCA.

90. In response to **question 28**, the government is right to state that it is important that the new regulators are able to raise appropriate funding to cover their costs. But it is essential that the totality of these costs across the PRA and FPC is carefully monitored throughout the transition process. Close regard must be paid to the subsequent fees levied on firms should, particularly given the regulatory principle of economic efficiency that applies to both regulators.

91. Subject to seeing further detail, we would support the fee levying process to be simplified by collection through one organisation, as this could reduce duplicate costs and inefficiencies.

Compensation, dispute resolution and financial education

92. Care needs to given to what unintended consequences might result from efforts to increase transparency and the accountability of the Financial Ombudsman Service.

93. It is important to recognise that Ombudsman determinations relate to individual complaints with specific circumstances. There are a number of risks in publishing information that enables incorrect read-across of specific determinations on to a range of cases that might be considered 'similar' by some.

94. It is unclear what the government is trying to achieve by increasing the transparency of individual, specific decisions, particularly when the existing FSA Dispute Resolution (DISP) rules already account for cases that have 'wider implications'.

95. Given that the government is proposing for the FCA to draw on wider sources of intelligence in indentifying risk, we believe that there is a case to be made for greater accountability of the FOS. Ombudsman determinations could have an increasing role in developing regulatory requirements, effectively establishing precedents by which firms will need to abide. Unless a framework can be established that allows determinations to be challenged more effectively through the courts, such as through the Upper Tribunal, we would prefer the role of the Ombudsman to be limited to making individual determinations on specific cases, subject to existing wider implications provisions in DISP.

European and international issues

96. We believe that there will be significant challenges in maintaining a coherent, consistent UK voice in international discussions. Although we support the government's proposal to establish an MoU to help shape this, we believe that this should be further enshrined in the day-to-day operations of both regulators.

97. We would welcome assurances that both regulators will give due consideration to impending European or international developments 'in the rear-view mirror', prior to consulting on and implementing UK regulation.

98. It is difficult to envisage under what circumstances both prudential and conduct regulation representation or engagement would not be required, considering the far-reaching consequences of international financial regulation reform.

If you have any comments or queries on this response, please contact Nick Wood
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April 2011

Response to the Consultation Paper by

Credit Services Association

and

Debt Buyers and Sellers Group

A new approach to financial regulation: Building a Stronger System

HM Treasury and Dept for Business Innovation and Skills
Issued February 2011

1. Executive Summary

- Whilst there has been a highly successful working relationship with the Office of Fair Trading, the Credit Services Association (CSA) and the Debt Buyers and Sellers Group (DBSG) together referred to as 'the Association', support the Government's preferred option, that being Option 1, transferring the granting of licences and the job of regulation to the soon to be created Financial Conduct Authority (FCA).
- The Association is however, keen to draw attention to the concerns this option raises in this consultation response and believes the Association can bring proven skills and experience and be a valuable member of the team that ultimately puts together the specialist rule book for the debt collection and purchase industry, incorporating our voluntary code, the CSA Code of Practice.

The Association believes the following need further consultation before a FSMA style Rule Book is written and consideration needs to be given to these items now if any there could be any impact to legislation in the meantime – further details can be found later in this document:

- **Potential limited knowledge of the debt collection and purchase industry** – the industry is unique and we would be concerned if the rules did not take this into consideration and were only drafted from a creditor's perspective

- **Change for change sake?** – There are parts of the existing Consumer Credit Act which should be retained

- **Potential loss of Voluntary Codes and the parts they play in regulation** – voluntary codes are specifically drafted for an industry and are, therefore, an excellent basis for rule books and a way of gaining acceptance from the industry

- **Outcomes regulation** – we believe this would be difficult to apply fully in the debt collection and purchase industry

- **Cost of regulation –** could be prohibitive for some of the Association's members – uses a different model to a trade association who can subsidise smaller members fees

- **The loss of smaller operators** – due to the complexity and administration of new regulation

- **Reduction in competition** – due to loss of some operators

- **Capital adequacy** – debt collection and purchase is a relatively simple business model which does not require large reserves of capital

- **Appointed representatives –** we do not see how this would work in this industry and are concerned that it would result in indirect regulation of the industry -we are not involved in such activities as selling loans, life assurance, or

taking deposits, and therefore it is hard to see how there would be a benefit or practical application

- **Transition arrangements –** these will be critical, particularly as the changes have been described to us as an 'evolutionary' rather than revolutionary process and we would ask for a 'grandfathering' principle to be adopted

Throughout this document, we talk about giving support for Option 1, whilst also highlighting our concerns for the application of a new regime. We have also taken this opportunity to provide some background information on the way our industry works and how we can offer guidance and support to the new regulator.

2. Background Information about the Association

The Credit Services Association (CSA) is the only national association in the UK for businesses specialising in debt recovery, tracing and related services. It also incorporates the Debt Buyers & Sellers Group (DBSG), with members ranging from high street banks to credit reference agencies and debt buyers. Our aim is to continually develop and uphold the highest professional standards across the credit industry.

Around £20bn of debt is passed to CSA members each year for collection (around 15 to 20 million cases), and we return over £2bn to the UK economy every year from this debt. At its peak in 2007, around £7.5bn of debt was bought by our DBSG members. Our clients include major financial institutions, government departments and local authorities, utilities, mail order and telecoms companies.

The CSA has 338 members, and the DBSG has 80 members, with 46 being members of both. Around 90% of the debt collection agency (DCA) companies and most of the debt buyers operating in our industry are members of the Association.

Most creditors insist that the DCAs they use are members of the CSA as they value the benefits membership of the Association brings, particularly the Code of Practice to which all members have to agree to follow.

20% of the Association's membership consists of 'larger' companies with around 80% of the business in our industry being conducted through them. These companies collect nationally and employ somewhere between 100 and 700 people each. The remaining 80% of the membership are small to medium sized enterprises, often employing less than 20 people.

The smaller companies account for about 20% of the activity in our industry, but provide often highly specialised niche services recovering both consumer and commercial debt to local businesses and are an important and integral part of the industry despite their size.

The collection of debt is based on a relatively simple model which involves a client (a creditor for example) passing a number of debt cases (i.e. accounts which have defaulted and are in arrears) to a DCA, who then makes attempts to contact the customers, negotiate affordable repayment plans where the creditor had failed to do so and return the money to the client less an agreed rate of commission based on the amounts collected.

The same model applies in principle for a debt purchaser, only in this case the debt is purchased from the creditor for an agreed amount per £ face value of the debt, title passes to the purchaser and all the funds collected are retained by the purchaser.

The Association has Three Main Goals:

1. Promoting Fairness for all

- Continually raising the professional standards of our members
- Ensuring consumers receive timely, accurate information and advice
- Protecting and advising the honest consumer
- In return, the customer has a responsibility to provide information and tell the truth

2. Improving Data Quality and Access

- Improving data quality from creditor to credit reference agency to buyer/agent
- Registering up to date details of individuals' financial circumstances at credit reference agencies
- Reduction of "mis-trace" by means of access to the full electoral register
- Further access e.g. via NCOA, NI numbers and tax information

3. The Right Balance of Regulation and Self-Regulation

- Encouraging proportional, effective regulation and enforcement from government
- Industry standards react more quickly than legislation, and are often more relevant
- Our new Collector Accreditation Initiative (CAI) is helping to ensure best practice and higher standards within consumer collections
- The DBSG Continuous Improvement Programme (CIP) provides for comprehensive, independent, standard-based audit of debt buyers
- The CSA has well-respected complaints handling processes and new sanctions
- The CSA and DBSG work closely with the OFT on debt collection guidance and recently helped enforce standard letter changes across the Association.

3. Response to the Consultation:

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

Not in scope of the CSA to answer.

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

Not in scope of the CSA to answer.

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

Unable to comment until it is known how the FCA will interact with the FPC in relation to ancillary credit business. If at all.

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

Outside of the scope of the CSA.

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

The strategic objective of financial stability is clearly sensible. It is unclear how the PRA's operational objectives are relevant to ancillary credit business such as debt collection as it is suggested that capital requirements are not strictly relevant to such businesses.

The regulatory principles would be useful provided they are adhered to. In particular the principle of the regulator exercising its functions transparently and the general principle that consumers are responsible for their decisions.

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

It is anticipated that the debt collection industry will be regulated by the FCA and not the PRA, therefore this question is outside of the scope of the CSA.

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

This remains unclear because it is not yet known whether ancillary credit businesses such as the debt collection industry will need to be subject to the approved person's regime. It is not clear if an approved person would exercise any significant functions that would affect the financial soundness of a debt collection firm.

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

This is outside of the scope of the CSA.

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

As far as it is relevant to the members of the CSA the accountability provisions would appear to be adequate.

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

At this time it is suggested that a flexible view is maintained with regard to the mechanisms for the engagement of the PRA with industry and the wider public. There may be a desire from either industry or the wider public for other methods of engagement.

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

It appears that little thought has been given to the ancillary credit businesses. For instance at it refers specifically to buying etc. *4.17 Nevertheless, as set out below, the Government does not believe that this objective should shift the responsibility for taking decisions from*

the consumer on to the regulator. The term 'appropriate' reflects the fact that different consumers require different degrees of protection, depending on their capability and personal circumstances, the product they are buying, and the channel through which they are buying it. At 4.10 of the consultation mention is made of functions being transferred across largely intact from the FSA. There is no such mention of the regulatory functions that effect the ancillary credit providers being transferred across from the OFT. Consequently there is a deal of uncertainty surrounding the on-going regulation of CSA members. It is suspected that this might be addressed in any rule book but this is not clear. For that reason the CSA would not wish to comment further on this aspect of the consultation.

12 What are your views on the Government's proposed arrangements for governance and accountability of the FCA? This is difficult to answer as it is presumed that the Markets and Consumer Panel (which has not yet been created) will have input/control of the rulebook that is applicable to members of the CSA. It is not apparent whether the Markets and Consumer Panel will be subject to the same accountability as set out for the FCA in the consultation.

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

(4.50) The relationship between the FCA and FOS is troubling as the FCA will provide the rule book for the regulation of firms. Will FOS judge complaints with regard to the rule book or will they use some unspecified criteria? If the latter how will the FCA be able to judge the intelligence from the FOS against the rule book. This does not appear to be a well thought out integrated system for the improvement of the retail financial system.

14 The Government would welcome specific comments on:

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

Transparency and disclosure must be used in a positive way showing both the good and the bad of a firm's behaviour. To do otherwise may encourage a culture of non-disclosure by firms with "spin" being placed on reports being passed to the FCA. It is arguable that the FCA should have to consider the reputational damage to a firm before any disclosure is made. If disclosure is made and the content of that disclosure is incorrect then there should be an obligation on the FCA to compensate the firm involved.

No comment is made in relation to financial promotions as this is outside of the scope of the CSA.

Warning notices that are published will have a reputational impact on the firm involved. It is of concern as a firm lending to a consumer is likely to receive fewer complaints than a firm engaged in debt collection. The debt collection firm will therefore be more visible (on the radar) of the FCA and might therefore have a higher risk of a warning notice being issued against it.

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

Outside of the scope of the CSA.

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

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

How would we know this separation between the two bodies is effectively maintained? What is the remedy if this breaks down?

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

This is unlikely to affect members of the CSA. It demonstrates that there is a hierarchy under the new regime.

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

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

It would appear bizarre to impose prudential requirements on ancillary credit businesses such as the debt collection industry. Consequently the lead option would appear to be the correct approach provided it was modified sufficiently to take account of this. Regarding Question 20, this appears sensible and not unlike the OFT consumer credit licencing regime in some respects.

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

As the new regime will incorporate more species of business than the present FSA regime then the approved persons scheme will have to expand to take account of this. There is no skillset in the FSA to deal with an approved persons regime for the ancillary credit businesses that would form part of the new regime if the FCA takes over the consumer credit functions of the OFT.

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

This is not within the scope of the CSA.

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

This is not within the scope of the CSA.

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

This is not within the scope of the CSA.

25 The Government would welcome specific comments on

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

There is the potential for members to be effected by this if the collections arm (which is regulated) is part of a larger unregulated entity. Consequently the whole group could be subject to regulation by the FCA. A distinction would have to be drawn between the two parts of the entity for prudential regulation if relevant.

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

Are the ancillary credit business that may be subject to this following the moving of regulation from the OFT to be subject to this?

This would appear to be a high cost model of regulation for such businesses. This appears aimed at the existing FSA regulated entities.

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

This is not within the scope of the CSA.

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

Either the FCA or PRA may charge fees for authorised persons as appropriate. If a firm is regulated by both the FCA and the PRA then fees are payable to both. Fees are also collected for the Consumer finance Education Body and the FOS. Members may need to prepare for this increase in fees over and above the OFT fees.

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

The operating model appears sensible.

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

FOS decisions are too often inconsistent, they are not guided by the law and when challenged there decisions can change. It is presumed that they will not be following the rules as set out by the FCA where a business will have no choice but to do so. Given this level of inconsistency and the risk of considerable reputational damage, then the proposal of giving FOS transparency powers should be abandoned.

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

Far more detail is required on this proposal. As it stands making the voluntary report compulsory appear weak without more.

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

Not within the scope of the CSA.

For further information please contact Claire Aynsley, Head of Membership, Compliance & Educational Services, Credit Services Association

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