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

08 September 2011 Ref:

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

Dear Sirs

A new approach to financial regulation: the blueprint for reform

By way of background, Baillie Gifford & Co is an independent investment management firm based in Edinburgh. We manage about £72bn, almost wholly on behalf of institutional clients, and employ about 670 staff. The firm is a private partnership established under the laws of Scotland and includes a group of companies which are authorised and regulated by the FSA.

We welcome the opportunity to engage in the consultation process on UK regulatory reform and wish to provide responses to the following issues which are particularly relevant to our business model, namely:

- The lack of certainty over the prudential regulation of our insurance subsidiary whose sole purpose is to write unit-linked insurance contracts;
- The broad definition of consumer within the draft legislation;
- The current structure of the permissions regime.

We have also had the chance to review the views of our trade body the Investment Management Association and endorse their submitted paper.

Q4: Do you have any comments on the objectives and scope of the PRA, as described in paragraphs 2.46 to 2.61 and in Chapters 3 and 4?

A significant issue for Baillie Gifford is the current uncertainty as to which of the PRA or the FCA, will be responsible for the prudential regulation of our life company subsidiary which provides unit-linked insurance contracts to pension schemes, as a means of gaining access to our investment management capability. As currently drafted, it appears that the PRA will prudentially regulate this subsidiary, but as an asset management group, the FCA will be the primary prudential and conduct regulator. As a consequence, we are unclear as to how this split of responsibilities will operate in practice, and it will lead to further complexity and cost in supporting both regulatory relationships,

A list of the partners' names is available at the above address.
Authorised and regulated by the Financial Services Authority.

INVESTORS IN PEOPLE

when we presume a firm such as Baillie Gifford Life Ltd, was not initially within the thinking behind the PRA's scope of activity.

We would therefore welcome a provision for firms with insurance subsidiaries, whose sole purpose is the writing of unit-linked reinsurance contracts, to be regulated by the FCA.

Q6: Do you have any views on the FCA's objectives – including its competition remit – as set out in paragraphs 2.80 to 2.90 and in Chapters 3 and 4?

The draft legislation provides a very broad definition for the term 'consumer' under which the FCA will look to meet its operational objective to secure an appropriate degree of protection for consumers. In the FSA's Financial Conduct Authority: Approach to Regulation paper, they acknowledged the different degrees of protection required by 'financially sophisticated consumers' and 'retail consumers'. Their paper however failed to explain how the definition of 'consumer' in the draft legislation would work in practice alongside the current MiFID definitions of 'retail' and 'professional' clients. As a firm, we support the aim for high standards of conduct in the UK financial system but are concerned about how the FCA approach might impact on how we communicate with and act for professional clients. We would therefore like clarification on how the broad definition of consumer will fit with the current MiFID definition of client.

Q14: Do you have any views on the detail of specific regulatory processes involving the PRA and FCA, as described in paragraphs 2.150 to 2.195 and Chapters 3 & 4?

An area that we believe the government should be looking to update is the current Part IV permission regime and Regulated Activities Order. The permission regime comes from legislation which predates the FSA and through its transition into the FSMA 2000 and subsequent operation, it has become an increasingly complex and confusing basis upon which to build a regulatory authorisation requirement. It is also not consistent with the EU directives governing most of the activities of many firms.

The creation of the FCA and PRA therefore presents an opportunity to revisit this permissions regime and improve on the current complexity and uncertainty.

If you have any questions regarding the content of our submission, please do not hesitate to contact me.

Yours faithfully

Graham Laybourn
Head of Regulatory Risk

HM Treasury Consultation

A new approach to financial regulation: the blueprint for reform

Response from Barclays
September 2011

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1. Executive summary

1.1 The design of the UK's new financial services regulatory regime is of great significance to the future resilience of the financial system and the wider health of the UK economy. Barclays supports the overarching framework and structure proposed in the Draft Financial Services Bill (the "**Draft Bill**").

1.2 We welcome the fact that the Treasury has been committed to an open process of consultation and Barclays has taken every opportunity throughout to provide feedback. We also welcome the fact that the Draft Bill now reflects many changes and developments that have been suggested by the industry and others. However, we believe that there remain crucial areas where changes are still necessary to strengthen and improve the legislative proposals.

Objectives

1.3 The Bank of England (the "**Bank**") should be given a financial (stability) policy objective to match and mirror its monetary policy objective. This would ensure that:

a) its objective is clearer, more definable, and deliverable, focusing on providing a "sustainable credit supply"; and,

b) financial stability policy would be sensitive to, and rooted in, the wider context of economic policy and growth.

1.4 There should be recognition in the general objectives for the Prudential Regulation Authority (the "**PRA**") and Financial Conduct Authority (the "**FCA**") of the need for authorised persons to contribute to the growth of the economy, and for regulation and supervision to take account of this. A careful balance is needed between the dangers of excess risk tolerance (to stability and consumer detriment) and insufficient risk tolerance (with corresponding impact on innovation and economic activity).

Accountability and governance

1.5 The Financial Policy Committee (the "**FPC**") should have the operational independence to set its own strategy within the framework of a strengthened remit set by the Chancellor. The FPC should then be accountable to Parliament and the Government to deliver on this strategy.

1.6 Governance arrangements for the FPC would be strengthened if they mirrored the Monetary Policy Committee (the "**MPC**") arrangements more closely.

1.7 We see some potential conflicts between the FPC and PRA including where the FPC makes recommendations to the PRA, particularly considering the shared composition of their management.

Judgement-led supervision and powers

1.8 Whilst we support the move to more judgement-led regulation, this must not come at the cost of consistency, legal certainty, and due process.

1.9 We are concerned that key principles such as providing guidance, the duty to consult, and the right to refer a matter to an independent body for review have been unnecessarily weakened or removed altogether.

1.10 We support the PRA and FCA being given an appropriate toolkit to achieve their objectives, but new powers must not cut across human rights law and the need for a fair trial. So, disclosures of warning notices should only be permitted in exceptional circumstances and should follow best practice to ensure that representations from the affected persons/firms are taken fully into account.

1.11 For similar reasons, the Tribunal should be enabled to exercise the full decision-making right following a review of the merits of the case through access to the formal courts system, rather than giving it a more limited role akin to judicial review.

1.12 Early intervention powers (such as product bans and powers to publish directions on financial promotions) should be focused on meeting clearly identifiable policy outcomes, designed with appropriately strong safeguards, and applied proportionately to address well-defined instances of consumer detriment. Dialogue should be encouraged and innovation should not be stifled.

National and international coordination

1.13 The success and efficiency of the new 'Twin Peaks' model will partly depend on careful coordination and, wherever possible, joint working between the regulators.

1.14 It will also be vital that the FPC takes the lead in ensuring that the UK can adequately respond to EU and global supervisory and stability developments. Similarly, the PRA and FCA must be mindful of European law and of the powers of the newly created European regulators. There should be recognition of the impact of the new EU supervisory framework on the exercise of judgement and discretion at member state level.

1.15 It will be important that the Bank, PRA and FCA all devote sufficient time and resources to ensure that the UK is able to maintain sufficient influence with the European Systemic Risk Board (the "**ESRB**") and the European Supervisory Authorities (the "**ESAs**"). A culture where close and careful collaboration with the relevant international bodies will need to be further developed and maintained.

2 Bank of England and Financial Policy Committee

Introduction

2.1 Barclays welcomes the overarching framework and structure proposed in the Draft Bill to establish clarity of responsibility for the regulators.

2.2 We also recognise and support the value of close coordination and policy coherence between macro-prudential policy and micro-prudential supervision. We therefore welcome the establishment of a financial policy committee to analyse macro-prudential risk, help develop tools, and take action to deal with risks that threaten the stability of the financial market.

2.3 We fully support the thrust of the legislation which will ensure, crucially, that the FPC has the powers and the political independence to be able to execute its strategy. This should complement the continued role that the democratically accountable Government must continue to play in overseeing economic policy generally, including in a crisis. We believe that the easiest way to achieve this will be to ensure that the FPC mirrors the MPC as closely as possible on objectives, Government-set remit, and a suitably accountable governance framework.

The Bank's Financial Stability Objective

2.4 We welcome the fact that the Bank has taken greater responsibility for financial stability since the introduction in 2009 of a financial stability objective into the Bank of England Act 1998. We agree with the broad aim to seize the opportunity presented by the Draft Bill and the creation of the FPC to strengthen this objective further. However we think that the Draft Bill should recognise the ongoing responsibility of HM Treasury (the "**Treasury**") in the field of financial stability and that the objective itself should be appropriately balanced against other key public policy objectives.

Taking account of economic growth and defining financial stability

2.5 We agree with the Treasury's view that, "stability is an appropriate prerequisite for sustainable growth". However, we would welcome greater recognition of the fact that measures to enhance stability can lead to the direct and, on occasion, significant detriment to economic growth. For example, powers to direct regulators to increase capital ratio requirements can have the effect of dampening the credit supply and so may stifle growth.

2.6 We are also concerned that, in isolation, the Bank's financial stability objective fails to explain what financial stability is, or what the appropriate level of financial stability should be that the Bank, and by implication the FPC, should aim for. However, we appreciate that defining the concept of financial stability in primary legislation could prove too restrictive and inflexible.

2.7 We propose a simple solution. The successful model of the Bank's monetary policy objective should be followed far more closely for financial policy. Using the wording in s. 11, Bank of England Act 1998, s.2A should be redrafted as:

> *"In relation to financial policy, the objectives of the Bank of England shall be –*
>
> *(a) to maintain a sustainable supply of credit, and*
> *(b) subject to that, to support the economic policy of Her Majesty's Government, including its objectives for growth and employment"*

2.8 This wording would ensure that the Bank, and FPC, had a definable objective which was also sufficiently sensitive to wider economic policy. The focus on "a sustainable supply of credit" is clearer than the currently proposed wording, and more adequately reflects the fact that measures to enhance stability may dampen credit supply. However, it will also be broad enough to enable the Bank and FPC to address a full range of potential systemic risks which would immediately or eventually pose a threat to the "sustainable supply of credit".

2.9 In a recent paper, Andy Haldane, outlined some of the considerations needed in applying macro-prudential regulation. The paper illustrates the balance needed and the potential impact on credit supply:

> *" In framing macro-prudential policy today, both these factors need to be weighed: on the one hand, enhancements to the risk-bearing capacity of the financial system to repair balance sheets; on the other, encouragement for the risk-taking capacity of the system to boost credit supply. These factors can sometimes point in subtly different directions. The first might point to higher buffers to boost banks' risk-bearing capacity, while the second might point to lower buffers to boost their risk-taking capacity."*[1]

2.10 Even if the Bank's financial stability objective remains unchanged from the current proposal, we would strongly urge that the second part regarding growth should be incorporated.

The Bank's Financial Stability Strategy

2.11 New s. 9A, Bank of England Act 1998 provides that the Court of the Bank of England (the "**Court**") must "determine the Bank's strategy in relation to the Financial Stability Objective". We do not think that the Court is the appropriate body to discharge this function as, due to its governance structure, it is not suited to directly observing, influencing, or holding the FPC to account (see paragraph 2.23 below).

2.12 Whether our recommendation regarding the Bank's objective above is taken up or not, the Treasury should set a clear remit based on its economic policy objectives (addressed further below under 'accountability' when we comment

[1] Andy Haldane, Bank of England, Speech – 'Risk Off', 18 August 2011.

further on new s. 9D.) Whilst a hard numerical remit – as with the MPC's inflation target – may not be possible with an objective for "sustainable credit supply" or financial stability, this will ensure that the Bank and FPC have a working understanding of the wider economic policy context to be able to deliver against the second part of the objective we proposed in paragraph 2.7 above. With the objectives and remit as we propose, the FPC should be then given the full operational independence to determine its own strategy through which, as with the MPC, it can be held accountable to the Chancellor and Parliament.

2.13 In addition, s. 9A(2) states that, in determining and/or revising the strategy, the Court must consult with the FPC and with the Treasury. Consultation has been a fundamental pillar of the UK regulatory system thus far, and we would ask the Treasury to ensure that it remains so. We believe it is important that the consultation on the strategy is cast more widely and made public.

The international dimension

2.14 As the Treasury recognises, instability can, and does, spread across borders. Coordinating internationally when faced with potential cross-border risks will be essential if regulatory and supervisory action is to be effective. We think that this could be addressed in two ways. First, by adding (at the end of s. 2A(1), Bank of England Act 1998) the words "*having regard to the international nature of financial markets that operate there*". Also, by having sufficient mechanisms in place to ensure that the UK system can adequately influence and respond to EU and Global supervisory and stability developments.

The FPC's Objectives

2.15 We support the objectives of the FPC (as set out in new s. 9C, Bank of England Act 1998).

2.16 Notwithstanding our strong view that economic growth is a concept that should be enshrined in the Bank's financial stability objective, we welcome the fact that new s. 9C(4) requires the FPC to assess the impact of its actions on the capacity of the financial sector to contribute to the growth of the UK economy in the medium or long term.

2.17 If, after reconsidering its position as we have requested, the Treasury is still of the view that s. 9C provides the adequate emphasis on economic growth, we would ask the Treasury to consider:

a) removing the words "in its opinion" from this subsection, as we think that it would be more appropriate for the Treasury, in its setting of the FPC's annual remit and under its monitoring of the FPC's discharge of its functions, to determine what is and what is not likely to have a significant adverse effect on the growth of the economy; and,
b) replacing the word "significant" with the word "material", as we think that this represents a more proportionate threshold for assessing the adverse impact of the FPC's exercise of its powers.

Future Functions of the FPC

2.18 We would welcome further clarity on what is envisaged by new s. 9F(2), Bank of England Act 1998. Under this subsection, the Court is permitted to "*arrange for specified functions of the Bank to be discharged by the FPC*". Whilst we appreciate that flexibility is often desirable in shaping a new regulatory framework, we would be concerned that any additional responsibilities or functions given to the FPC could potentially present a distraction and cloud its overarching financial stability objective. We ask the Treasury to reconsider whether this level of flexibility is in fact needed and, if it is deemed necessary, there should be a requirement on the Treasury itself to evaluate whether the proposed new responsibilities or functions are sufficiently relevant and connected with the FPC's main objectives. These new powers should then be subject to agreement by Parliament.

Accountability

2.19 We are aware that there is motivation to de-politicise decision making on financial stability issues and we support both the independence of the Bank, and its responsibility for issues relating to system-wide financial stability. Whilst having the powers to make decisions and take action will be crucial for the Bank, we still think that overall responsibility for economic issues should lie with the democratically accountable Government. The Bank should, therefore, retain some level of real accountability to the Government. We believe these fundamental principles are compromised by two key aspects of the Draft Bill:

a) The wording in new s. 9D, Bank of England Act 1998 is not sufficiently robust. Allowing Government to make recommendations to the FPC, and the FPC to decide "*whether or how far it accepts any recommendations*" does not seem to ensure the right split of responsibilities and discretions, whilst maintaining an adequate level of accountability. We believe that the Treasury should set a clear remit based on its economic policy objectives and on the Bank's, or FPC's, financial stability strategy. The FPC would then have the independence to act within the scope of this high-level direction.
b) Both the Bank's, or FPC's, financial stability strategy and the remit set for the FPC should be publicly consulted on, laid before Parliament and agreed by affirmative resolution.

2.20 Only in the presence of strong safeguards, such as consultation and accountability to Parliament, do we believe the FPC will be able to make decisions free from political sway, but rooted in the wider economic context.

2.21 Finally, we believe that it would be beneficial for the remit, any guidance, and recommendations provided by the Treasury to the FPC to be published to ensure there is absolute transparency and clarity of the terms by which the FPC is operating.

Governance

2.22 As we stated in previous consultation responses, the current proposals for the membership of the FPC is somewhat skewed in favour of the Bank, with eight of the 12 members being public officials or regulators and six coming under the direct or immediate sphere of influence of the Governor. We believe that a better balance would be achieved if there were to be six external independent members and fewer Bank executives. This would be more closely aligned to, for example, the principles for good corporate governance set out by the Financial Reporting Council, which states that there should be: "*A balance of executive and independent non-executive directors.*"[2]

2.23 We also do not believe that it is appropriate for the FPC to be a sub-committee of the Court of Directors of the Bank as we question how the Court could exercise appropriate oversight of the FPC. The current proposals give the Court responsibility, but they do not set sufficient accountability or governance frameworks. We think that the FPC should, instead, look and feel a lot more like the MPC. It could therefore be a committee of the Bank itself, or, at the very least, include non-executive members of the Court. This would align arrangements with those for sub-committees of boards in corporate structures. The presence of non-executive directors (alongside the executive directors) on the sub-committees of a board in the corporate world is a strong governance mechanism that adds legitimacy.

Quorum

2.24 As we also mentioned in our response to "A new approach to financial regulation: building a stronger system" (the "**February Consultation Paper**"), the presence of a single external member within a quorum of seven (excluding the Treasury representative) does not seem sufficient to ensure good governance. Having such a heavily Bank-weighted quorum would not adequately reflect the make up – even designed in its current proposed form – of the committee.

The chairman

2.25 We have some concerns about the breadth and span of important policy responsibilities that will sit with the Bank group and vest in the Governor and his immediate team. These responsibilities include:

a) Macro-prudential policy, analysis and application of tools
b) Monetary policy and application of tools
c) Micro-prudential supervision of banks and insurance companies within the Bank group
d) Crisis management responsibilities
e) Resolution authority responsibilities
f) Central bank 'lender of last resort' policy and application and liquidity provision

[2] Financial Reporting Council, The UK Approach to Corporate Governance, October 2010

g) Regulation of systemically important infrastructure

2.26 We are not aware of so much responsibility being vested in any other central bank in the developed world, and are concerned about the 'concentration risk' where multiple responsibilities are vested in a small number of senior individuals as well as possible conflicts of interests, self review, possible over-burden and decision bottlenecks.

2.27 We believe that the fact that the same individual will be the chairman of the FPC and the PRA could lead to potential conflicts, and dangers of self review, in particular given the FPC's ability to make recommendations to the PRA and the PRA's discretion as to whether it accepts these recommendations or not. A situation where an institution chaired by an individual has to decide whether to accept recommendations provided by another institution chaired by the same individual appears to us to be inherently conflicted. The regulated community is required to put in place appropriate mechanisms to allow it to manage conflicts of interest, or to ensure that they do not arise, in the conduct of its daily activities. We do not see why the Government should not wish to place similar obligations on the regulators.

Macro-Prudential Tools

2.28 We welcome the Treasury's recognition of the novel nature of macro-prudential tools and note that the FPC will provide an update to the Treasury on its thinking on the topic by the end of the year. With this in mind we think that procedures should be in place to ensure the maximum possible transparency whilst recognising that there is a clear need for rapid action to be possible in certain cases. As the IMF has recently stated: "*What macro prudential policy can deliver is somewhat of an unknown in any country. So, as in other countries, there will be a need for communication on an ongoing basis to keep macro prudential expectations reasonable*."[3] We would strongly support the IMF's call and recommend full consultation at three levels:

a) On the design of the tools themselves in secondary legislation (it is crucial that the Treasury conducts full consultation on the scope and design of potential tools before they are set out in secondary legislation);
b) On the FPC's general policies in relation to the use of the tools (which should be public); and,
c) On any proposed use of the tools where there is no urgency (for example adjusting the costs of credit as a bubble gradually emerges).

2.29 The Treasury should place the FPC under a statutory duty to consult on the use of a particular tool in a particular case before using it, with an exemption for emergency situations.

[3] The International Monetary Fund, United Kingdom: The Future of Regulation and Supervision Technical Note, Country Report 11/230, July 2011, page 22.

2.30 Whilst we recognise that some level of jurisdictional discretion in the use of tools may, at times, be required, it is essential that the UK engages fully in the international debate. Coordination with the Financial Stability Board, the Basel Committee on Banking Supervision, and the European Systemic Risk Board will be vital to ensure effective and co-ordinated input in the design of tools as well as ensuring a level playing field.

Coordination of Crisis Management

2.31 We welcome the fact that a draft memorandum of understanding ("**MoU**") between the Bank and the Treasury on coordination of crisis management arrangements will be published during pre-legislative scrutiny of the Draft Bill.

2.32 We support the view of the Treasury Select Committee that the democratically accountable Government must take the lead in a crisis situation. The Chancellor will clearly have to take responsibility for all decisions involving public money, but should also take the lead in a situation where issues have been identified by the FPC and in which public funds could be at risk.

Recognised Clearing Houses ("RCHs")

2.33 We are broadly supportive of the approach now being proposed regarding RCHs. We fully support the Treasury's stance that the new European Market Infrastructure Regulation ("**EMIR**") regime must maintain a level playing field across all European member states with regard to the clearing of euro denominated and other business.

Information Gathering

2.34 We support the introduction of new s. 9V (1) Bank of England Act 1998, setting out the principle that the burden of requesting information must be proportionate to any benefits that may be derived from analysing that information, into the Bank of England Act 1998. Information requests, where not appropriately targeted, can add to the burden on firms, particularly at times of market or firm-specific stress.

2.35 We also welcome the fact that the protections against disclosure as set out in s. 348, Financial Services and Markets Act 2000 ("**FSMA**") have been maintained and emphasise the importance of s. 348(1) FSMA, which states that, "*Confidential information must not be disclosed by a primary recipient, or by any person obtaining the information directly or indirectly from a primary recipient*".

2.36 Given the new powers of the Bank to require the PRA and the FCA to provide information (as set out in new s. 9U, Bank of England Act 1998), we believe that the Bank (including its committees) should also be covered by the restrictions in s. 348 FSMA. This could be achieved by an amendment to the definition of "*primary recipient*". Beyond this, we think that there should be robust statutory rules governing the gathering, use, storage, and sharing of information by the

Bank. We would also welcome the requirement for the Bank to hold an annual or biennial review to remove disclosure requirements which are no longer relevant.

2.37 We are concerned that new s. 9V(4), Bank of England Act 1998 gives the bank discretion to publish information relating to directions that it gives to the PRA and/or the FCA under s. 9U without taking account of the adverse effects that publication may have on the affected firms. Publication of the mere fact that the Bank is interested in such information could send signals to the market that the Bank is concerned about the safety and soundness of the affected firms. This could tip an existing recoverable situation beyond recovery or, in some cases, crystallise a stress scenario or crisis which did not exist in the first place. We believe that the obligation in s. 9V(4) should be framed in such a way so that only firms affected by the relevant direction receives notification of it or, at the very least, that the Bank is required to consider whether publication is likely to adversely impact the business of the relevant firms.

2.38 We also note that, in the February Consultation Paper, the Treasury proposed that it would introduce a statutory bar, making it illegal for the PRA and FCA to disclose information received from the Bank which is excluded from the Freedom of Information Act 2000. We indicated that we supported this approach, but we cannot see that this proposal has been reflected in the Draft Bill. We urge the Treasury to proceed with this ban as initially proposed.

3 Prudential Regulation Authority

Introduction

3.1 Barclays welcomes the Government's commitment to more effective prudential supervision. We acknowledge that a key aspect of the Government's strategy to achieve this will be the separation of prudential and conduct regulation. We also recognise there will be greater focus on supervisory judgement, although we believe this needs to be balanced with proper guidance, transparency, legal certainty, and a need to take into account the impact of the regulator's actions on sustainable economic growth.

Objectives and remit

3.2 We recognise that benefits can be achieved through the separation of prudential regulation from conduct regulation as long as there is strong and effective coordination between the different supervisory bodies. (see section 4 below).

International dimension and economic growth

3.3 As we indicated at paragraphs 2.5-2.10 above, we believe that UK regulators should be required to take account of the wider economic context within which the UK financial system operates. In addition, we think that the PRA, like the FPC, should be required to have regard to the impact of its actions on sustainable economic growth. We acknowledge that the Government intends that the UK regulatory system should have a lower risk tolerance than that of the Financial Services Authority (the "**FSA**") before the crisis. However, insufficient risk tolerance may have unintended consequences on innovation and economic activity, just as there are risks to financial stability and consumer detriment with excessive risk tolerance. A careful balance is required. We therefore suggest that new s. 2B(2) FSMA should read as follows:

> "*The PRA's general objective is promoting the safety and soundness of PRA-authorised persons, whilst having regard to the need for PRA-authorised persons to support economic activity in the United Kingdom.*"

Proportionality and UK competitiveness

3.4 As we have stated in paragraphs 2.5 and 3.3 above, insufficient risk tolerance and proactive measures to enhance stability may have a direct and adverse effect on growth and UK competitiveness. For this reason, we believe it is vitally important that proportionality and the recognition of competitiveness are hard-wired into the principles of regulation for the PRA and that 'proportionality' is determined through evidence based analysis. We would therefore ask the Treasury to consider:

a) including a new principle in new s. 3B FSMA that could be framed as:

"*The general principle that consideration should be given to the wider economic impact of decisions taken, including the impact on the competitiveness of the UK*";

and,

b) an amendment to s. 3B(1)(b) to strengthen the principle of proportionality by requiring the PRA to assess the burden and the benefits of a restriction on the basis of a rigorous impact analysis.

Additional Objectives of the PRA

3.5 We note that new s. 2D FSMA allows the Treasury to provide additional objectives for the PRA in the future. We understand that new powers may be necessary over time, but these must be compatible with the main 'safety and soundness' objective. In addition, any new objectives for the PRA should be subject to public consultation and approval by Parliament through affirmative resolution in the same way as the current proposed objectives will be.

3.6 We would therefore ask that s. 2D be amended to include a duty for the Treasury to consult publicly before exercising this power.

Certainty and consistency

3.7 We note that new s. 22A FSMA allows the Treasury to specify by order the regulated activities that are PRA-regulated activities. We also note that in paragraph 2.58 of the White Paper, the Treasury concludes that it would not be feasible to "*define the scope of PRA supervision of investment firms on the face of the Draft Bill*." Some PRA regulated banking groups will include smaller non-bank investment firms also operating in the UK. Such firms, as well as Barclays, would benefit from some clarity and certainty on designation under s. 22A FSMA.

Judgement-Led Regulation

3.8 We recognise the advantages that will come from the focus on judgement-led regulation, including increased flexibility. However, this flexibility must not be obtained at the cost of consistency, legal certainty and due process, which are crucial elements of a strong legal and regulatory framework.

3.9 We appreciate that a judgement-driven culture will require a marked shift from tick-box compliance with rules and guidance by empowering regulators to make judgements that are tailored to specific firms in specific circumstances. Similar firms should be treated consistently in similar circumstances, and dual-regulated firms should be treated consistently by both regulators. Failure to do this could result in regulatory arbitrage. We address the issue of how these powers will be exercised and how regulators will coordinate in the section 4 of this response.

3.10 The regulators must be mindful of European law and the powers of the newly created European regulators, and ensure a consistent supervisory approach with both the EU and the wider international regulatory framework.

3.11 Firms will continue to need access to publically available standards and well-defined guidelines to allow them to operate and make business choices with a degree of certainty on a day-to-day basis. Businesses cannot be run compliantly in a vacuum, and so it is important for the functioning of the new framework that general rules and regulatory guidance are drafted in clear, specific terms, and introduced in a way that is procedurally and substantively fair.

3.12 We welcome the fact that the FSA rule-making powers have been reproduced in relation to both the PRA and the FCA. However, we note that the Treasury has not proposed to give the PRA statutory powers to issue guidance, in the same way that it has done in s. 139A FSMA in relation to the FCA. The lack of such a statutory framework means that the PRA will be entitled to choose whether or not to make its views public on particular areas. A statutory power to issue guidance would ensure due process. Consultation should not be left to the discretion of the PRA to use or not as it sees fit.

3.13 We have similar concerns in relation to the "statements of purpose" that the PRA has said that it will issue to explain the intentions behind its rules. We note that these statements are not expected to be issued in accordance with a power or process set out in FSMA, and so the PRA will have discretion as to what areas those statements cover and whether it seeks representations from firms likely to be affected. Moreover, whilst we agree that informing firms of the purpose behind each rule is useful to allow firms to formulate appropriate policies and ensure that they operate in accordance with the regulators' expectations, simply knowing the purpose of a rule does not always assist a firm in understanding how the regulator expects an outcome to be achieved.

Due process

3.14 We are concerned that the Draft Bill provides limited rights to firms wishing to challenge regulators' decisions, and that in some important areas there will be no such right at all. Although we appreciate that firms will rarely need or want to challenge the decisions of a prudential regulator before a tribunal, we believe the right to refer a matter to an independent body for review is an important principle of law. This will be an important safeguard in a new system that will be heavily reliant on individuals making decisions, often with the advantage of hindsight and with potentially serious impact on a firm's business.

3.15 On a more specific point, relating to "section 166 reviews", new s.166A FSMA provides an override of any contractual clauses in place with third parties which protect confidentiality. No override of contract law should be taken lightly. The sweeping powers of s.166 are exacerbated by the fact information requirements under this section extend beyond the reporting requirements set out in the FSA's Handbook. These powers should be refined and curbed given the cost implications for firms.

The PRA's Pro-Active Intervention Framework

3.16 We understand that the PRA's mode of supervision will be based on a Pro-Active Intervention Framework (the "**PIF**"). Whilst we understand that the PIF is not a feature that will be established in the Draft Bill, we believe that an important protection should be inserted into FSMA to prohibit the disclosure of the score. Just as with the current ARROW ratings, some supervisory concerns may later prove to be unfounded. Public disclosure could affect the share price of a firm and create possible instability. We therefore recommend that a provision is inserted into FSMA requiring the PRA to protect highly market sensitive Information, including the PIF scores, from public disclosure.

Governance and Accountability

3.17 We welcome the fact that the PRA will be an autonomous subsidiary of the Bank with its own board and governance structure. We also welcome that new s. 3C FSMA requires the PRA, in managing its affairs, to "*have regard to such generally accepted principles of good corporate governance as it is reasonable to regard as applicable to it*". However, as we outlined in paragraph 2.27 above, we have concerns about potential conflicts of interests arising from the fact that the PRA will have the same chairman as the FPC.

Duty to consult

3.18 We believe that a strong duty to consult will be a central pillar of accountability for the PRA. We would draw the attention of the Treasury to the current Organisation for Economic Cooperation and Development (the "**OECD**") paper which reinforces the need for member states to apply transparency and process disciplines to their policy making. In particular, Principle 2 states that authorities should "*orient regulatory policy around the needs of users and adhere to principles of open government, including transparency and participation. This includes providing meaningful opportunities (including online) for the public to be consulted in the process of preparing draft regulatory proposals and the supporting analysis*."[4]

3.19 We note that the Draft Bill states that the FCA "*must make and maintain effective arrangements for consulting practitioners and consumers on the extent to which its general policies and practices are consistent with its general duties*", and that this must include the establishment and maintenance of a practitioner panel. The equivalent arrangements for the PRA, set out in s. 2J FSMA, seem to impose a much narrower duty to consult and leave the establishment and maintenance of an expert panel at the discretion of the PRA.

3.20 We believe that the PRA and FCA should, wherever possible, be subject to equivalent statutory checks and balances. We are also concerned that such an imbalance could add to the perception that the FCA is a 'junior partner' to the PRA. We urge the Treasury to strengthen the PRA's duty to consult in the areas we have highlighted and to set the PRA Practitioner Panel in statute.

[4] **OECD, Draft OECD recommendation on regulatory policy and governance, June 2011.**

Permission to carry on regulated activities

3.21 New schedule 6, part 1, paragraph 5A FSMA contains a new power determining that business models have to be deemed “suitable” before being able to “carry on”. Barclays supports the need for the PRA to ensure that firms have, and continue to maintain, suitable business models. However, we would urge that the PRA takes a cautious and proportionate approach to deeming that a business model may not be suitable given the potentially significant effect this could have on a firm should it become public knowledge, including: share price instability; ability to raise funds in the market; enter into a contract; risk of loans (repayable on demand) being called in; and, ultimately whether the firm is able to stay in business.

3.22 Given the potential implications, we believe that further safeguards should be built-in to the legislation, including:

a) that decisions on suitability must be based on significant and adequate evidence, with involvement of the PRA’s senior business advisors; and,

b) that the PRA’s decision must be ratified by a committee consisting of the Treasury, Bank of England and the FCA. The right of the PRA to issue a public warning notice that it is investigating should not apply in respect to business model suitability. See our comments on warning notices in paragraphs 4.6-4.9 and 4.26-4.30.

4 Financial Conduct Authority

Introduction

4.1 We support the FCA's single strategic objective to protect and enhance confidence in the UK financial system and the operational objectives that will underpin this. Regulatory certainty is an important step in restoring public trust and confidence in the financial system and we welcome the opportunity to comment on the future role of the FCA.

4.2 We are responding separately to the paper published in June 2011 on the Financial Conduct Authority's approach to regulation (the "**FCA Approach Paper**").

Objectives and Remit

4.3 The PRA's general objective, as outlined in new s. 2B(2) FSMA appears to overlap with the market integrity objective of the FCA, set out in new s. 1D(1) FSMA.

4.4 New s. 1D (2) provides that "the 'integrity' of the UK financial system includes (a) its soundness, stability and resilience..." We believe that the "soundness, stability and resilience" of the UK financial system are primarily matters for the FPC (at the macro-prudential level), and for the PRA (at the firm-specific level). We recognise that the FCA will have prudential responsibility for firms that are not prudentially regulated by the PRA, but believe that the FCA's remit as a conduct regulator should not be blurred or diluted with such a broad objective that would better sit with the FPC or PRA.

Competition

4.5 We welcome the Government's assertion that the FCA will not be an economic regulator. We also welcome the FCA's duty to discharge its (general) functions in a way that promotes competition so far as this is compatible with its objectives. However, as we explain in more detail in our comments on price intervention in paragraph 4.20-4.22 below, we are concerned that the way in which the FCA will interpret its duty to promote competition may go beyond what is normally to be expected of a conduct regulator. With this in mind, we ask that the Government be clear in the draft legislation about what the competition role means.

The FCA's Early Intervention Powers

4.6 We appreciate that the Government wants to create an effective and efficient new regulator, with the appropriate toolkit at its disposal to achieve its objectives.

4.7 However, we firmly believe that a framework for a strong regulator must also contain strong safeguards to ensure that the regulator exercises its powers in the considered and proportionate manner in which the Government intended, and

to seek to avoid costly and time-consuming legal challenges (such as judicial review and injunctions).

4.8 In addition, any amendments that are made to the processes for assessing or publicising disciplinary action against a firm should be fully considered for compliance with the Human Rights Act and the European Convention on Human Rights. We understand that the statutory notice procedure and rights to refer a matter to the Tribunal for a "de novo" hearing were provided in FSMA to ensure compliance with human rights law. Any early disclosure of warning notices, summary prohibition on using particular financial promotions and limitations on the scope or nature of the review before the Tribunal give some cause for concern. A firm's products, marketing material, technology and intellectual property are its belongings, which it should be free to use within the boundaries of the law and for the benefit of its shareholders and clients.

4.9 We would also suggest that, in most cases, similar outcomes to those intended are already capable of being achieved under the existing framework. Our specific concerns on each of the proposed new powers and processes are set out below.

Product intervention

4.10 In our response to the February Consultation Paper, we stated that product intervention could have a "potentially chilling effect on innovation that would be hard to reconcile with the FCA's operational objective to facilitate efficiency and choice". We remain concerned that if parameters and expectations are too narrow, the innovation, diversity and competitiveness that characterise the UK market will be adversely impacted. We therefore ask the Treasury to consider imposing a higher threshold for the exercise of this power than for use of general rule making powers, to ensure that the product intervention rule-making power is not used routinely. Hence, we believe that the "necessary or expedient" test in new section 137C(1) FSMA should be reconsidered.

4.11 Where product intervention is justified, the Treasury should consider and provide for the right outcome for those consumers that may already have purchased the product in question and who may find themselves locked into products that may have been altered or banned. Rendering contracts unenforceable that were entered into lawfully and in accordance with the rules prevailing at the time, or giving the FCA the power to do so, would add a risk of retrospective application and legal uncertainty that we do not think is necessary or warranted and could have a severe impact on public confidence in the market and potential knock-on effect on a firm's overall financial stability.

4.12 We also have the following drafting observations in relation to the current proposed text:

a) **Application to unregulated products**. We ask the Treasury to clarify the text of new s. 137C(5)(a) FSMA, as we are concerned that it has the

potential to be interpreted as allowing the FCA to use its product intervention powers to ban products that are currently not regulated by the FSA. We assume that this is not the intention, and that instead the reference to the fact that powers may be exercised even if entering into the relevant agreement is not a regulated activity is intended to cover circumstances where the activity would have been a regulated activity but for the availability of an exclusion in a particular case. We ask the Treasury to ensure that the legislation only allows the FCA to operate within the scope of the activities that Parliament has given it power to supervise under the RAO. If a new activity or product is in future identified as meriting regulation by the FCA, such activity or product should first become a regulated activity or specified investment before the FCA is entitled to exercise any powers in relation to it.

b) **Safeguards for temporary bans**. We do not think that suitably robust safeguards have been set out in the Draft Bill in relation to temporary product bans, as new s. 138N FSMA allows the regulator ample discretion to disapply the obligation to consult under s. 138J in the case of temporary bans, and there is no right for firms to refer the regulator's decision (either to dispense with consultation or to impose a temporary product ban) for scrutiny by the tribunal. We think that the words "necessary or expedient" in s. 138N suggest that the discretion can be used more widely than in extreme or emergency situations, and could potentially be satisfied in almost any case where the regulator has assessed that a product or a product feature is unsuitable for a particular market. In the absence of a formal product pre-approval process, and of a right of appeal to the tribunal for affected firms, strong safeguards are required to ensure that legal certainty is maintained in relation to existing contractual arrangements, except in the most serious of cases.

4.13 We note the Treasury's assertion that the FCA's new product intervention power is "unlikely to be appropriate in relation to the protection of professional or wholesale customers".[5] However, the definition of "consumer" in new s. 1C FSMA covers a wide spectrum of market participants, and so linking product bans to the FCA's consumer protection objective does not, by itself, achieve the stated aim. A different aim is also highlighted in the FCA's Approach Paper. This identifies that there are direct links between certain wholesale market activities and the retail market, and by suggesting that interventions may occur at a higher level in the product distribution chain to avoid that a potentially unsuitable product may reach retail consumers.

4.14 If the intention is to require the FCA to focus the use of this power on protection of retail customers, we suggest that a new (and narrower) definition of "consumer" should be introduced into the Draft Bill for these purposes, or that the power should be limited to instances where the FCA is able to establish a

[5] para 2.100 "A new approach to financial regulation: the blueprint for reform"

close and clear relationship between the activity or product that it wishes to ban and the fact that that activity or product is reasonably expected to result in customer detriment in the retail market.

4.15 If, however, the intention is that the power should remain as widely crafted as it currently is in the Draft Bill, then we would ask the Treasury to ensure that the legislation requires the FCA to differentiate its approach between different categories of consumers. It can be argued that the most sophisticated market users, with equal access to market information and quality advice, do not require, nor should benefit from, the level of protection afforded to less sophisticated and/or well-resourced market users seeking to make similar investments. Importantly, more sophisticated market participants will not want to incur the added cost and burden associated with a higher level of regulatory protection.

4.16 We believe that the client classification regime under the Markets in Financial Instruments Directive ("**MiFID**") provides an appropriate framework for tailoring the level of protection afforded to clients of differing expertise (including the option for clients to "opt-down" to a level of increased regulatory protection). The Treasury will no doubt be aware that it and the FCA will need to have regard to the implications on the client classification regime of the review of MiFID that the European Commission is currently undertaking as it develops its thinking.

4.17 As part of this review, the European Commission is proposing to introduce powers to ban specific activities, products or practices in certain circumstances, and we urge the Treasury to align the UK rules with the European approach once this has been formulated. We are concerned that unless common standards are applied in the context of a single market, incoming EEA firms that are outside the FCA's remit may gain an unfair advantage over UK–based firms and that the ability of the UK sector to innovate may be damaged, along with the pace of innovation in and responsiveness of the UK market.

4.18 With regards to sales practices, we recognise that a broadening focus of carefully applied regulation from point-of-sale to further up the retail product development chain, including product governance, is appropriate. However, we believe that the FSA already has sufficient powers to regulate sales practices. No regime can be designed to guarantee that in every instance the product sold matches perfectly the needs of the consumer who bought it. In fact, attempting to put controls in place to verify if that is the case risks stifling the interest of product producers in innovating to meet emerging consumer needs and, therefore, the range of choice available for consumers. A market must retain an element of "caveat emptor" in order to function sustainably.

4.19 The challenge is ensuring that the consumer has all the appropriate information available to make an informed choice and that the design of the product is not inherently biased against consumer preference. We believe that the "Treating Customers Fairly" initiative has led to substantive progress in this area and should continue. Alongside this, it is essential that the new regulatory arrangements strike the right balance between accommodating the financial

sector's need to be responsive and innovative while delivering appropriate and proactive challenge.

Price intervention

4.20 Notwithstanding the Government's intention that the FCA should not be an economic regulator, we are concerned by statements (both in speeches and in the FCA approach Paper) that indicate that the FCA may become involved in commercial pricing decisions.

4.21 We believe that intervening in private contracts where prices are not manifestly unreasonable and are disclosed in plain intelligible language goes beyond the remit of a financial regulator. It also goes against existing legislation, such as the Unfair Terms in Consumer Contracts Regulations 1999, which provide that "in so far as it is in plain intelligible language, the assessment of fairness of a term shall not relate... to the adequacy of the price or remuneration, as against the goods or services supplied in exchange".

4.22 We therefore ask the Treasury to consider elaborating further on the FCA's duty to promote competition as set out in the Draft Bill, so that the FCA does not seek to stray into the remit of an economic regulator.

Directions on financial promotions

4.23 We note that new s. 137P FSMA will enable the FCA to issue a direction requiring a firm to withdraw a financial promotion that it has made or approved, where the FCA considers that that financial promotion breaches or is likely to breach any of the FCA's financial promotion rules, and to publish the fact that it has done so.

4.24 We appreciate that there is pressure on the FCA to act, and to be seen to act, to protect consumers from being misled. However:

a) We do not think that the rapid action that is possible by the Advertising Standards Authority (the "**ASA**") is an appropriate analogy to prompt provision of rapid response powers for the FCA. The ASA is a voluntary code enforcer that operates by consent and as a result considerations of public law (such as those under the Human Rights Act) do not apply to it. Any statutory public authority should proceed with a great deal more care and process as it does not operate by consent and is subject to human rights legislation.

b) The FSA already has the power to take action in relation to financial promotion under the existing FSMA framework, and firms already do amend or withdraw financial promotions on the request of the FSA's Financial Promotions Team.

4.25 If the Treasury decides to progress with the proposal as currently drafted, we would ask it to consider two aspects of the draft text that we feel require further attention:

a) we think that ss. 6(d) should provide a statutory minimum period for firms to make representations, rather than leaving it entirely at the discretion of the FCA; and;

b) ss. (11) seems to us to defeat the object of a direction being revoked. If the FCA comes to the conclusion that the direction is not in fact appropriate and the financial promotion is therefore not in breach of the relevant rules, we cannot see what benefits publication of the details would achieve for consumers.

Publication of warning notices

4.26 We have serious reservations about the publication of warning notices and believe that a firm should not be subject to disclosure of disciplinary investigations at an earlier stage than FSMA currently allows, except for in a very limited subset of cases. When the regulator serves a warning notice on a firm, it has not yet heard the firm's considered representations on the matter raised in that notice, and so disclosure at that stage may cause significant harm to the firm's reputation and business.

4.27 In addition, we do not believe that the criminal process, with early disclosure of a person being charged, is a helpful or relevant analogy. The criminal process in the UK is backed up by a widely understood presumption of innocence that is not replicated in a disciplinary case. The decision makers in a criminal case (the magistrates, judges or jury) are also separate and independent from those who bring the charge, which supports the presumption. Again, this is not the case in relation to a warning notice, as the decision maker in the case of a decision notice and (unless challenged before the Tribunal) a final notice will be the FCA in each case. As a result, the message that disclosure of information about a warning notice would send is that the firm is "guilty as charged" and so disclosure could have a significant detrimental impact on the reputation of the firm even where the firm is ultimately able to successfully defend itself or settle the dispute to the regulator's satisfaction.

4.28 For these reasons, we would ask the Treasury to consider whether a more proportionate outcome could be achieved by using the FSA's existing powers to seek appropriate undertakings from firms to correct the conduct or breach to which the warning notice refers, and to reserve use of the duty to publish details of the notice for those cases where the firm is uncooperative.

4.29 However, if the conclusion is reached that the policy intention can only be achieved by the introduction of this power, we ask the Government to consider limiting publication to cases where the FCA is able to establish that, despite the potential damage to the firm in question, publication can be justified on the basis of significant public interest (e.g. because there is a need to warn consumers) or because there is disruption in the markets caused by uncertainty as to whether the regulator is investigating the firm or any of its senior management.

4.30 Moreover, and particularly if the legislation is not further tightened as we have suggested, we ask that significant safeguards and protections are introduced for the subject of the action. We believe that this should include:

a) **A presumption or objective measure of "unfairness".** We welcome the fact that new s. 391(6) FSMA requires the FCA to assess whether publication is unfair to the person in question. However, in particular where the affected person is a firm, we cannot envisage many instances where publication would not carry a risk of unfairness, and so we think that a more appropriate safeguard would be for the legislation to set out a presumption that regulators could rebut in specific cases (for example, in the cases of consumer interest or market disruption that we have identified above). In addition, we note that the Draft Bill does not specify how firms are to demonstrate that publication is unfair to them and so, in the absence of a presumption, we would welcome greater guidance on how unfairness is to be measured. This guidance could either be set out in the Draft Bill itself, or the Draft Bill could impose a duty on the FCA to issue such guidance under s. 139A.

b) **An adequate period in which to make representations**. The proposed change in the period of time available under s. 387(2) FSMA for firms to dispute the giving of warning notices (from 28 days down to 14 days) is unlikely to allow firms sufficient time to gather the information required to support its representations, in particular if that process will apply, as we assume that it will, to disputing both the giving and the publication of the notice.

c) **A right of appeal**. S. 391 should give firms the right to refer the FCA's decision to publish a warning notice to the tribunal for a review on its full merits. As we will explain in more detail below, appeal rights are an essential safeguard in building a regulatory system that confers greater powers and discretions on the regulator.

d) **An equal duty to publish exonerations**. The reputational damage suffered by firms subject to a warning notice details of which have been published may be considerable, and so we ask Government to impose a duty on the FCA to give equal priority and publicity to the withdrawal of warning notices as to the issuing of the original notice.

e) **The removal of statutory immunity**. The FCA's statutory immunity from liability in damages should be carved back in the event that it chooses to make a disclosure which relates to a notice that does not proceed to a successful enforcement action on the same or substantially the same matter and charges. This would protect a firm whose reputation may be harmed and which may suffer associated financial consequences from inappropriate disclosure.

Right of Appeal

4.31 We are concerned that firms' rights to refer a regulator's decision on appeal to the tribunal under s. 133 FSMA are changing, so that in some important areas there will be no such right (other than by means of judicial review where the relevant grounds can be satisfied), and in some cases, although the right exists, the tribunal will not be entitled to come to a view on the merits of the decision being challenged so as to substitute that decision for its own.

4.32 This is of particular concern to us in the area of conduct regulation, where the FCA is being given some new and very wide-ranging powers, the exercise of which will have a direct and potentially significant impact on a firm's business. It is, therefore, fundamental that the FCA is required to follow due process and, given the English law presumption of innocence until proven guilty, firms have appropriate rights of challenge and access to a fair hearing.

Governance and Accountability

4.33 We are content with the governance and accountability framework proposed for the FCA.

5. Coordination and regulatory processes

PRA/FCA Coordination

5.1 Barclays acknowledges the Treasury's intention to have clear distinctions in divisions of responsibility between the PRA and FCA and welcomes the recognition in the White Paper for the need for "*effective coordination mechanisms*".

5.2 We agree that such mechanisms are needed and would suggest the easiest way to ensure appropriate levels of coordination would be to provide a statutory duty for the PRA and FCA to work jointly wherever possible. The operational manner in which this duty can be delivered should, as the White Paper suggests, be determined by the regulators themselves.

5.3 As we made clear in our responses to previous consultations, it will be critical that firms can expect consistency of approach and that they are not subject to overlapping, disproportionate, and costly regulatory burden exacerbated through duplication of effort on the part of the dual regulated. In particular, the prudential treatment for a particular activity should be identical, irrespective of whether it is subject to PRA or FCA prudential supervision.

5.4 We support the fact that a memorandum of understanding will be published on coordination and that this will be subject to review on an annual basis as outlined in s.3E (4) FSMA. Given the importance of effective coordination, we suggest that there should be a duty to consult as part of this review process.

5.5 We would recommendation close study of the situation in France where the "Pôle commun" between the French regulators, Autorité de Contrôle Prudentiel ("**ACP**") and the Autorité des marchés financiers ("**AMF**"), where a strong mandate for coordination is set out in an MoU and is exemplified by the joint annual reports produced[6].

Overlapping powers

5.6 We note that there are some overlapping powers in the Draft Bill where firms could be subjected to regulation from both the PRA and FCA. An appropriate level of certainty for firms could be achieved through the reduction of some of this overlap. Areas of possible concern include:

a) Threshold conditions analysis (55B, FSMA)

b) Exercising the power to impose requirements on permissions, and the cancellation of permissions (55J, 55L and 55M, FSMA)

c) Approvals for controlled functions (new s. 59A FSMA)

[6] See http://www.abe-infoservice.fr/IMG/rapportGB.pdf for an English version.

d) Overlapping rule making powers (which seem to be exercisable by the PRA without consulting the FCA)

e) Information gathering by each regulator

Managing the risk of disorderly failure

5.7 We recognise that the PRA is likely to be in the best position to have a holistic view of dual-regulated firms. We welcome and support, therefore, the safeguards proposed in new s.3J, FSMA, regarding the PRA veto over FCA actions where the PRA considers actions may lead to the disorderly failure of a firm.

Variation and removal of permissions

5.8 We welcome the reference in paragraph 2.155 and 2.156 of the White Paper that the PRA and FCA should consult each other before exercising the Own Initiative Variation of Permission ("**OIVoP**") powers.

EU coordination

5.9 EU regulation, whether through Directives and Regulations or binding technical standards developed by the new ESAs, or ESRB, will be increasingly important. It is important that the PRA and FCA devote sufficient resources to European work and to representing the UK on relevant bodies such as ESMA. The PRA and FCA should, wherever possible, work with industry to maximise UK influence in shaping the debate in the EU.

5.10 Wider coordination of the UK regulators will also require that EU developments are appropriately factored into the FCA's development plans. With the FCA alone, these developments include MiFID, Packaged Retail Investment Products, the Market Abuse Directive, the Credit Agreements related to the Residential Property Directive and others. In the context of a single market, the UK should not gold-plate or front run EU developments, absent pressing and manifest need, lest this creates an opening for regulatory arbitrage with incoming firms that are not subject to UK requirements seeking to target UK investors.

5.11 Also, see paragraphs 3.10 and 4.16-4.17.

Annex: Question and answer map

1 Do you have any specific views on the proposals for the FPC as described in paragraphs 2.6 to 2.24 and in Chapters 3 and 4?

Yes. See Chapter 2 of this response.

2 Do you have any specific views on the proposals for the Bank of England's regulation of RCHs, settlement and payment systems as described in paragraphs 2.32 to 2.40 and in Chapters 3 and 4?

See paragraph 2.33 of this response.

3 Do you have any comments on:

- **the proposed crisis management arrangements; and**
- **the proposals for minor and technical changes to the Special Resolution Regime**

as described in paragraphs 2.41 to 2.44 and in Chapters 3 and 4?

See para. 2.31-2.32.

4 Do you have any comments on the objectives and scope of the PRA, as described in paragraphs 2.46 to 2.61 and in Chapters 3 and 4?

See para. 3.1-3.6.

5 Do you have any comments on the detailed arrangements for the PRA described in paragraphs 2.62 to 2.78 and in Chapters 3 and 4?

See para. 3.8-3.22.

6 Do you have any views on the FCA's objectives – including its competition remit - as set out in paragraphs 2.80 to 2.90 and in Chapters 3 and 4?

See para. 4.1-4.5.

7 Do you have any views on the proactive regulatory approach of the FCA, detailed in paragraphs 2.91 to 2.110 and in Chapters 3 and 4?

See para. 3.7-3.30.

8 What are your views on the proposal to allow nominated parties to refer to the FCA issues that may be causing mass detriment?

No specific comment.

9 What are your views on the proposal to require the FCA to set out its decision on whether a particular issue or product may be causing mass detriment and preferred course of action, and in the case of referrals from nominated parties, to do so within a set period of time?

See para. 4.10-4.19.

10 Do you have any comments on the competition proposals for the FCA set out in paragraphs 2.111 to 2.119 and in Chapters 3 and 4?

See para. 4.5 and 4.20-4.22.

11 Do you have any views on the proposals for markets regulation by the FCA, described in paragraphs 2.120 to 2.123 and in Chapters 3 and 4?

See para. 4.13-4.16.

12 Do you have any comments on the governance, accountability and transparency arrangements proposed for the FCA, as described in paragraphs 2.124 to 2.132 and in Chapters 3 and 4?

See chapter 4 on points related to transparency. See 4.33 on governance and accountability

13 Do you have any comments on the general coordination arrangements for the PRA and FCA described in paragraphs 2.138 to 2.149 and in Chapters 3 and 4?

See chapter 5.

14 Do you have any views on the detail of specific regulatory processes involving the PRA and FCA, as described in paragraphs 2.150 to 2.195 and in Chapters 3 and 4?

See chapter 5.

15 Do you have any comments on the proposals for the FSCS and FOS set out in paragraphs 2.196 to 2.204 and in Chapters 3 and 4?

No.

Submission by Bluefin Insurance Services Limited
HM Treasury consultation document
A new approach to financial regulation: the blueprint for reform

1 Do you have any specific views on the proposals for the FPC as described in paragraphs 2.6 to 2.24 and in Chapters 3 and 4?

Answer: We agree with the proposal.

2 Do you have any specific views on the proposals for the Bank of England's regulation of RCHs, settlement and payment systems as described in paragraphs 2.32 to 2.40 and in Chapters 3 and 4?

Answer: We agree with the proposal.

3 Do you have any comments on:

• the proposed crisis management arrangements; and

• the proposals for minor and technical changes to the Special Resolution Regime

as described in paragraphs 2.41 to 2.44 and in Chapters 3 and 4?

Answer: We agree with the proposal.

4 Do you have any comments on the objectives and scope of the PRA, as described in paragraphs 2.46 to 2.61 and in Chapters 3 and 4?

Answer: We agree with the proposal.

5 Do you have any comments on the detailed arrangements for the PRA described in paragraphs 2.62 to 2.78 and in Chapters 3 and 4?

Answer: We agree with the proposal.

6 Do you have any views on the FCA's objectives – including its competition remit - as set out in paragraphs 2.80 to 2.90 and in Chapters 3 and 4?

Answer: *Warning notices.* We have concerns in respect of the proposed new power in relation to publishing warning notices.

This has the potential to cause serious harm to a firm's business reputation. Discretionary authority granted to the FCA as to when not to publish a warning notice even if discussed with the firm in question prior to publication, is not a sufficient check or balance.

There also seems to be an underlying assumption that a warning notice would always lead to a successful enforcement action. As this cannot be the guaranteed outcome in all cases, a process for publishing a "notice of discontinuance" is proposed. Whether this would result in a firm being seen as innocent of an alleged offence or merely guilty but not proven and with consequent reputational damage, cannot be predicted with any certainty.

Therefore, we would prefer the existing process of publishing enforcement notices be retained as that is in line with the legal principle of the assumption of innocence.

***Definition of "consumer".* As there seems to be nowhere else to raise this issue we are doing so here. We have concern in relation to the definition of "consumer". The suggestion that this would include other regulated or exempt firms whilst carrying out regulated activities and as part of a chain leading to the ultimate customer of a financial service or product.**

We do not believe that in the context of insurance intermediaries, which our firm is, that the definition of consumer should or requires to, be extended beyond those who contemplate or actually purchase an insurance policy under which they are the policyholder.

Those practitioners in a chain leading to the policyholder are subject to regulation. They are required to be competent in managing the services and products they offer so the additional

protection granted to a policyholder or prospective policyholder, is unnecessary and inappropriate to their role.

7 Do you have any views on the proactive regulatory approach of the FCA, detailed in paragraphs 2.91 to 2.110 and in Chapters 3 and 4?

Answer: ***Sector-specific approach to conduct regulation.*** **We agree with this proposal and in particular are concerned by suggestions that considerable investment in resources may be needed for FCA and reference to new units such as a business and market analysis team.**

We do not believe that insurance intermediary supervision by FSA has failed or that there is evidence of a need to mend a failure in this respect. We would respectfully comment that any increased fees or levies should be proportionate, appropriate and cost-effective in relation to the specific service which insurance intermediary firms will receive from the FCA.

Product intervention. **We acknowledge and agree that the FCA should not take on the role of vetting and pre-approving products.**

For the efficiency of markets and to ensure responsibility in this respect remains firmly with firms' senior management, we see FCA's role as one of monitoring development of products and intervening only at the point at which it believes there is potential for customer detriment.

Becoming involved with individual products prior to their launch would risk FCA's resource being deflected from its primary regulatory and supervisory role. It might also present potential customers with the misleading picture of quasi FCA approval of a product.

We also do not see this as a relevant tool in respect of insurance intermediaries and development of general insurance products in response to customer demand.

Warning notices **– please see our answer to Question 7.**

Financial Promotions **- We agree with the proposal.**

8 What are your views on the proposal to allow nominated parties to refer to the FCA issues that may be causing mass detriment?

Answer: We agree with the proposal.

9 What are your views on the proposal to require the FCA to set out its decision on whether a particular issue or product may be causing mass detriment and preferred course of action, and in the case of referrals from nominated parties, to do so within a set period of time?

Answer: We agree with the proposal.

10 Do you have any comments on the competition proposals for the FCA set out in paragraphs 2.111 to 2.119 and in Chapters 3 and 4?

Answer: We agree with the proposal.

11 Do you have any views on the proposals for markets regulation by the FCA, described in paragraphs 2.120 to 2.123 and in Chapters 3 and 4?

Answer: We agree with the proposal.

12 Do you have any comments on the governance, accountability and transparency arrangements proposed for the FCA, as described in paragraphs 2.124 to 2.132 and in Chapters 3 and 4?

Answer: We agree with the proposal.

13 Do you have any comments on the general coordination arrangements for the PRA and FCA described in paragraphs 2.138 to 2.149 and in Chapters 3 and 4?

Answer: We agree with the proposal and although those firms regulated solely by FSA may not appear to have an interest in a successful coordination process we are mindful of the potential for such process to create precedent with wider application so see the close and regular communication between PRA and FCA as essential. In addition, as the PRA will represent the UK on EIOPA cooperation and coordination between PRA and FCA will be pre-requisite for

conduct issues that will arise from the likes of the revision of the Insurance Mediation Directive.

14 Do you have any views on the detail of specific regulatory processes involving the PRA and FCA, as described in paragraphs 2.150 to 2.195 and in Chapters 3 and 4?

Answer: We agree with the proposal.

15 Do you have any comments on the proposals for the FSCS and FOS set out in paragraphs 2.196 to 2.204 and in Chapters 3 and 4?

Answer: *FSCS.* We believe that two issues are essential in this respect and should not be overlooked during the development of the PRA and FCA.

First, any cross-subsidy between different types of regulated firms should cease and in particular, insurance brokers should not be at risk of funding compensation required for the banking sector.

Second that full-time, professional, insurance brokers should be separated from other, secondary sellers of general insurance currently in the FSCS's insurance intermediary sub-class.

Hopefully, these changes will be effective before the PRA and FCA are operative but they should still be noted.

End
07/09/2011

bba

The voice of banking & financial services

A new approach to financial regulation: the blueprint for reform

- Comments by the British Bankers' Association -

The British Bankers' Association welcomes the opportunity to comment on HM Treasury's consultation paper 'A new approach to financial regulation: the blueprint for reform'. We represent 220 banks from 60 countries and have 40 associate firms within membership.

Executive summary

Bank of England and the Financial Policy Committee

- We fully support the Government taking the opportunity of the review of the regulatory architecture to build a macro-prudential capability into the new UK supervisory regime.

- We believe the legislation underpinning the Financial Policy Committee should specify that its objective is to ensure a stable and sustainable *supply* of credit to the economy in the same way that the Monetary Policy Committee's remit is to ensure a stable *price* of credit and, subject to this, support the Government's economic policy and contribute to the Bank of England achieving its Financial Stability Objective.

- We have provided a high level analysis of the strengths and weaknesses of the macro-prudential tools and believe that their design and application should be guided by core principles including: simplicity; transparency; predictability; proportionality; and international coordination and reciprocity.

- We believe that macro-prudential policy in isolation will not be sufficient to deliver a sustainable provision of credit into the economy and that it must be coordinated not only with monetary policy but also with fiscal policy and micro-prudential regulation.

- We see grounds, however, for assessing whether the recently adopted changes to the Court of the Bank of England are sufficient in themselves for ensuring the effective oversight of the Bank executive in light of its significantly expanded range of responsibilities and believe that the accountability of the FPC to the Government and Parliament needs to be made more robust through reporting requirements on the part of the Governor as Chairman of the FPC.

Systemically important infrastructure

- We are content with the proposal that the Bank be given responsibility for systemically important infrastructure but would see a need for an MoU with the FCA given what appears to be a significant overlap in interest.

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Crisis management

- We are broadly content with the coordination mechanisms between the Bank and the Treasury proposed in the Treasury blueprint document but firmly believe that the duty on the Bank to engage with the Chancellor should not be on the basis of a possible call on public funds but instead on the likely use of the Special Resolution Regime given the reduced probability of a resolution requiring the use of public funds.

- The housing of responsibility for the triggering of the Special Resolution Regime and the application of the powers and tools is a significant departure from the current demarcation of powers and responsibilities and merits close attention.

- We support the other proposed changes to the Special Resolution Regime but would make the point that the consent required as part of part 5 of Clause 59 (S42A(4)) needs also to apply where property has subsequently been transferred and is no longer owned by the original transferee.

The Prudential Regulation Authority (PRA)

- We are supportive of the strategic emphasis on financial stability and the confirmation that the regime will not be operated on a 'zero-failure' basis. This is entirely consistent with the broad direction of travel of the reform programme pursued in recent years. But we view the lack of statutory principles relating to international competitiveness and the ability for financial services to innovate and contribute to economic growth as a shortcoming in the proposals.

- We support the move to judgement-led regulation and the principles behind the Proactive Intervention Framework but remain concerned about the prospect of firms being placed on a one-way downward trajectory if moving through the different stages became public knowledge.

- We see the Government's decision to leave the Tribunal's scope of review of supervisory decisions unchanged as a step in the right direction but are concerned that the Tribunal will no longer be able to substitute its own opinion for that of the regulator.

- We are pleased the Government agrees that the PRA board must provide a robust challenge to the executive, and that the board will have a non-executive majority complimented by the right balance of expertise. The independent non-executive directors will have an important role to play and attracting candidates of the right calibre will clearly be critical.

- We are pleased the PRA will have a duty to make and maintain effective arrangements for engaging with practitioners but view the Bill provisions requiring the PRA to "*make and maintain effective arrangements for consulting*" as unduly vague.

Financial Conduct Authority (FCA)

- We concur that the promotion of competition should be a secondary duty and that the FCA should be obliged to discharge its functions in a way which promotes competition, in so far as this is compatible with its primary objectives. Also appropriate is the proposed statutory power on the part of the FCA to make an enhanced referral to the OFT when it believes competition issues merit further investigation and remedy.

- We note that the proposed FCA objectives do not refer explicitly to growth or innovation. We would suggest this merits review given that growth and innovation are important elements of both the strategic objective of market users' confidence in the UK financial system; and of at least two of the operational objectives: protection for consumers -including protection of investors' right to seek real returns and issuers' right to seek economic capital - and efficiency and choice in the market.

- We welcome the acknowledgement that product intervention is unlikely to be appropriate in relation to dealings with professional and wholesale customers and not available for market integrity reasons, but accept that it does not automatically follow that any failings are such that the product intervention power should therefore be focused on retail 'consumer' protection.

- As the proposed FCA product intervention powers are substantial, we consider it important that the legislation is framed in a form that limits the possible circumstances for the powers to be used in an unintended way. In respect of the proposed new powers for banning products, we see the proposed language for the draft legislative provisions as being unduly wide. As for the publication of Warning Notices, we consider that regulators should be transparent and consistent in their decision-taking processes

- While we remain doubtful of the merits of the proposed publication of disciplinary action, we welcome the safeguards surrounding the powers of the FCA on early publication of disciplinary action, and the obligation to consult the person to whom a notice is given, however we see it as good governance that the Regulatory Decisions Committee should take this decision.

- We welcome the recognition of the need for consumer responsibility but see a need for the legislation to set out what this entails with greater clarity.

- On consumer redress, we need a better understanding of who the nominated parties would be in order to comment from a position of understanding. In principle we are not averse to a scheme similar to the 'super complaints' process under the Enterprise Act (2002) which has been used in financial services on a number of occasions and is now well-established. An immediate thought is that in order to avoid conflicts of interest it may be sensible for the legislation to exclude organisations that provide, promote or intermediate advice on financial services themselves from becoming a 'nominated party'.

- We also see a need for the legislation to set out the criteria for the bringing of a super-complaint and the provision of a statutory time limit for the FCA announcing how it proposes to deal with a complaint. We would also place the FCA under a statutory requirement to publish more substantive guidance on the super-complaints process including the factors which it will take into account in determining whether to permit a super-complaint, the evidence which it would expect to be provided in support of a super-complaint and the process it will follow in investigating a super-complaint.

- In addition to requiring the FCA to set out its decision on whether a particular issue or product may be causing mass detriment and preferred course of action, we see, first, the need to be able to challenge and test the FCA's thinking around the underlying issue and, second, a need for statutory provision to bring greater coherence to the statutory regime. At present, there are four different statutory tests for consumer redress: three in FSMA and one in DISP.

- We welcome the intention to establish a business and market analysis team and to base the FCA's policy and practice on such analysis. The value of this approach will depend crucially on retaining and recruiting high quality staff and ultimately the methodology it might choose to adopt. We suggest that the Client Asset Sourcebook Risk team (CASS team) could be the model the FCA uses for this and other specialist teams.

Coordination and regulatory processes

- We welcome the statutory obligation for FCA and PRA to coordinate referred to in paragraph 2.139 of the Treasury blueprint document; the specific statutory obligations for the existence and content of the MoU between them described in Paragraphs 2.140 and 2.141; and the provisions described in paragraphs 2.142 to 2.145 on maintaining its content and public accountability for its use.

- We encourage the MoUs to be developed as soon as practicable and welcome the proposal that regulators review MoUs at least annually and would further recommend that this be as part of a consultative process. We also look forward to publication by the Bank of England and FSA of plans on operational co-ordination later this year and again would underline the importance of consultation upon this document.

- Since many member banks will have dual regulators, we would welcome a forum which allows members to report to regulators how effectively the regulatory teams from different authorities are working together. We also see it as imperative that someone amongst the regulatory authorities has an overview and responsibility for overall co-ordination.

- We welcome the Government's commitment in paragraph 1.47 of the Treasury blueprint document for a simplified process on authorisation with one regulator taking the lead with processing an application. We encourage the Government to take a similar streamlined approach to the approved persons application process and variations in permission.

- We also see scope for confusion and contradiction between the rules of FCA and PRA, as described in paragraphs 2.168 to 2.170 of the Treasury blueprint document, especially taking into account interactions with European rule-making bodies. In addition to consulting each other and ensuring consistency between their rulebooks, we would suggest that the FCA and PRA should also pursue the FSA's existing policy of 'intelligent copy-out'.

- We support the view that where one group firm is PRA authorised, the PRA should be the prudential regulator for all group firms. This is by far preferable to the alternative approach set out in the Treasury blueprint document. Such an approach would seem particularly necessary in light of the Government concluding that it would not be appropriate to require the regulators to put in place a single rulebook.

- We note that the Treasury blueprint document proposes a new s.166A FSMA, granting both the PRA and FCA a new power to appoint a skilled person to "*collect and keep up to date*" information where an authorised person has contravened a rule which requires it to collect and update information. This is a significant extension to the powers the FSA has today and we would welcome further clarity regarding the conditions under which these powers would be used.

- We do not agree with the proposal relating to the withdrawal of permissions as there are circumstances where a firm may want to retain its permission for commercial reasons (e.g. to enable it to re-enter a market without having to apply to the regulator

for an extension). So long as the firm is prepared to pay the fee and comply with all regulatory requirements, it should be able to retain the permission.

- We are pleased to see that the PRA and FCA will be obliged to investigate and report on regulatory failure as we see sensible use of the findings, complementing market failure analysis, as important to ensuring that scarce PRA and FCA resources will be properly targeted. But we would suggest that the team undertaking the investigation and drafting the report for HM Treasury and Parliamentary review should be operationally independent from the area on which it is reporting.

European representation

- We would like to see the authorities give serious consideration to the benefits of maintaining a single international secretariat across the relevant authorities as a common shared service and the establishment of cross-authority teams to ensure that UK representatives at the three European Supervisory Authorities and other European and international committees are in a position to draw upon all relevant expertise and knowledge.

FSCS and FOS

- We believe that the FSCS and FOS should be placed under a statutory obligation to publish annual plans and that they should consult on these and be audited by the National Audit Office and therefore welcome the introduction of dual lines of accountability to both the PRA and FCA supported by oversight from the National Audit Office.

- We remain concerned however that the governance arrangements of the FSCS have not been sufficiently upgraded in light of the scale of the role now played by the scheme in respect of the financing of the ex ante costs of resolution and see a case in particular for the creation of a creditors committee in order to provide contributing institutions with stronger oversight of the value generation of 'bad book' assets.

Bank of England and Financial Policy Committee

1. Do you have any specific views on the proposals for the FPC as described above and in Chapters 3 and 4?

We have been firm supporters of the concept of macro-prudential regulation and the leadership position taken by HM Treasury and the Bank of England in the emerging international debate on the subject. We fully support the notion therefore that the Government should take the opportunity afforded by the review of the regulatory architecture to incorporate macro-prudential regulation into the new UK supervisory regime but also that careful thought must be given to its legislative underpinnings.

We believe that, as currently struck, the proposed framework falls short of setting a clear and simple mandate for the Financial Policy Committee and would urge the Government to consider the development of a regime analogous with that of the Monetary Policy Committee. This structure is well understood by the market and its democratic accountability via Parliament is clear. We believe, therefore, that there is a very strong case for the Financial Policy Committee's objectives, structures, proceedings, governance and accountability to, as far as is possible given their different functions, mirror those of the Monetary Policy Committee. Put simply, we believe that the FPC's remit should be to ensure a stable and sustainable *supply* of credit to the economy in the same way that the MPC's remit is to ensure the stable *price* of credit. This is not to say that we believe the Government should set a quantitative target on credit growth in aggregate but that the

Chancellor should outline the factors the FPC should consider when it is assessing the level of risk in the economy and the likely impact on the supply of credit. In our view, the remit letter should specify how the maintenance of financial stability should be balanced with economic growth – reflecting the desirability of credit growth varying somewhat across the cycle. We believe that framing the mandate in this way will underscore the dynamic nature of macro-prudential policy and offers much the same ability to promote financial stability while at the same time mitigating concerns about unnecessary constraints being placed upon growth.

Objectives

In the same way as the 1998 Act sets the objective for monetary policy as maintaining price stability and, subject to this, to support the economic policy of the Government, including its objectives for growth and employment, we believe that the legislation underpinning the FPC should specify that its objectives as being:

(a) to maintain a *stable and sustainable supply of credit* to the economy and
(b) subject to that, to support the economic policy of Her Majesty's Government, including its objectives for growth and employment.

The proposed objectives for the FPC as set out in Clause 9C(1) of the draft Bill – for the FPC to exercise its functions with a view to contributing to the achievement by the Bank of the Financial Stability Objective as further defined by 9C(2) and (3) – could then be set as 'specifications of matters relevant to objectives'.

In keeping with the 1998 Act, we believe that the Treasury should write to the FPC annually specifying the factors it is to consider when assessing the level of risk in the economy and its likely affect on the sustainability of growth, including how the maintenance of financial stability and the promotion of economic growth should be balanced.

Functions

We broadly agree with the functions proposed for the FPC. However, as we believe the FPC's objective should be to ensure a sustainable supply of credit to the economy, we consider that its principal function should be to assess whether the level of risk in the economy is matched by an appropriate level of capital. Here we agree with the proposed definition of 'systemic risk' proposed in new clause 9C(3) but would suggest that subsection (b) 'unsustainable levels of leverage, debt and credit growth' should rank ahead of subsection (a) 'systemic risks attributable to structural features of financial markets or to the distribution of risk within the financial sector'. The definitions provided in 9C(6) of the terms 'credit growth', 'debt' and 'leverage' look to us to be appropriate.

We note that 9F makes no provisions as to the order in which the FPC should generally exercise its functions. Whilst we agree with the White Paper that it would be inappropriate to specify ex ante a particular order, we suggest that the addition of a requirement that the FPC should go no further than is necessary for the purpose of pursuing the particular aim it has in mind would add necessary balance.

The use of 'have regard' in 9E (1) and (2) also look to us to be weak. We would suggest this be strengthened to emphasise, in particular, that any burden or restriction which is placed on a person or the conduct of an activity must be proportionate to the benefits expected to result from the imposition of that burden.

We understand the need for the FPC to have the ability to gather information and data necessary to perform its functions. However, we believe that the powers proposed in

clause 9U must be used in a proportionate manner; particularly the power in (7), which requires information to be verified ‘in such a manner as it may require’, should go no further than is necessary in the circumstances. Furthermore, we would suggest that to avoid duplicative requests for information, prior to requesting information from firms the FPC should first take into account information held by the FCA and PRA and that such a requirement could be framed in a form consistent with Article 15, *Collection and exchange of information,* of the European Systemic Risk Board’s founding Regulation (No 1092/2010) which sets out safeguards with regard to collecting information to avoid such duplication.

Potential macro-prudential tools

We welcome the approach being taken to evaluate the potential macro-prudential tools and stand ready to assist the interim FPC on this, either before the FPC reports to Parliament this year or after its Q1 2012 meeting. We provide a high level analysis of the strengths and weaknesses of the major tools in Annex 1 but suggest that the design and application of macro-prudential tools should be governed by an assessment of the extent to which they meet a number of principles. We would offer the following by way of example:

- A preference for simplicity;
- The need for transparency;
- An element of predictability;
- Proportionality; and
- International coordination and reciprocity.

These are largely self-explanatory. International coordination relates principally to the relationship between the FPC and the European Systemic Risk Board (ESRB); and reciprocity to the need for home country regulators to agree to apply macro-prudential tools to EEA firms operating in the UK market on a passported-in basis in order for macro-prudential policies to be as effective as they can be.

The authorisation process for the use of macro-prudential measures in clauses 9K and 9L look broadly appropriate, although we would repeat our view that Parliamentary oversight would be strengthened via the introduction of a sunset clause and that 9K(4) should place an obligation on the FPC to maintain a policy statement on how it intends to exercise its powers. We also note that Treasury will have the power where necessary, ‘*by reason of urgency*’, to grant the FPC new tools without first seeking Parliamentary approval. We note that under Clause 9L(3) orders made by reason of urgency will need to be laid before Parliament post-event and will cease to have effect unless approved by a resolution in each House within 28 days excluding time when Parliament is not sitting. This is an important discipline and entirely appropriate in the event of powers being exercised in this exceptional way.

We support the way in which the powers of the FPC to make recommendations within the Bank have been shaped (scoping out the provision of financial assistance to individual firms and the SRR powers available under the Banking Act 2009). We do not believe that the importance of the ability for the FPC to make recommendations to the Treasury can be overstated. The use of macro-prudential policy in isolation will not be sufficient to deliver a sustainable provision of credit and, through this, financial stability which we believe to be the objective of the regime. It must be coordinated with monetary policy but also with fiscal policy and micro-prudential regulation to be fully effective.

We note that the Treasury blueprint document identifies the need for the forthcoming revision of the Capital Requirements Directive (CRD IV) to permit member states to exercise discretion in the use of macro-prudential tools. We support the European

Commission's decision to require maximum harmonisation of the majority of the CRD IV requirements in the interests of promoting a safe and level playing field across the Single Market. That being said, we believe that the current iteration of the CRD IV text grants national authorities sufficient discretion to implement macro-prudential tools. We set out our understanding of this flexibility in the annex.

Membership and governance

We note the issues raised by the Treasury Committee during its recent inquiry into the accountability of the Bank of England and look forward to the Government's response and the conclusion of its deliberations concerning the balance between external and internal appointments. We see a case for assessing whether the changes made to the Court of the Bank of England under the Banking Act 2009 are sufficient to ensure robust oversight of the Bank's decision-making and due process given the range of additional powers which it will accrue. It may be for example that the responsibilities of the NedCo sub-committee should be reviewed to examine whether there should be a specific oversight objective in relation to the conduct of the FPC (to mirror that for the MPC).

Transparency and accountability

As argued above, we believe that there should be as much symmetry as possible between the FPC and MPC. We view the existing transparency and accountability mechanisms for the MPC as being sufficiently rigorous and understood and would therefore suggest they be adopted for the FPC. This includes the development of an equivalent to the letter the Governor is required to send the Chancellor if inflation diverges too far from the MPC's target. In the case of the FPC, we consider that this should take the form of a requirement for the Governor as Chairman of the FPC to write to the Chancellor to explain the decisions behind any direction or recommendation of the FPC. This letter should include a cost benefit analysis of the proposed direction or recommendation, and an economic impact assessment. The letter should be copied to the Chairman of the Treasury Committee.

We support the obligation for the FPC to prepare and publish bi-annual financial stability reports but, in keeping with our view that the FPC's primary objective should be linked to the sustainable supply of credit to the economy, suggest that the FSR should include an assessment of the sustainability of the supply of credit to the economy - Clause 9S(3) - and whether the level of risk in the financial system is appropriately matched by the level of capital.

Systemically important infrastructure

2. **Do you have any specific views on the proposals for the Bank of England's regulation of RCHs, settlement and payment systems as described above and in Chapters 3 and 4?**

We agree with the Bank being given responsibility for the regulation of settlement systems and recognised clearing houses, alongside its existing responsibility for recognised payment systems, but see a need for an MoU with the FCA given what looks like a significant overlap in interest. We would see the matters identified in paragraph 2.135 of the February 2011 HM Treasury consultation "building a stronger system" as providing a good starting point for the memorandum.

Coordination of crisis management

3. **Do you have any comments on:**
    - **The proposed crisis management arrangements; and**

- **The proposals for minor and technical changes to the Special Resolution Regime as described above in Chapters 3 and 4?**

Crisis management arrangements

We welcome the acknowledgement that there needs to be absolute clarity on how the Treasury and Bank group will coordinate their activities. The three specific mechanisms set out provide, in principle, an appropriate basis on which to coordinate:

- The statutory six monthly update meetings between the Governor and Chancellor on financial stability matters;
- A duty on the Governor to inform the Chancellor of possible calls on public funds; and
- The memorandum of understanding setting out how the Bank group and Treasury will coordinate and manage a crisis situation.

That being said, we believe that the duty on the Bank to engage the Chancellor should not be limited solely to circumstances in which there might be call on public funds. We consider that the likelihood of future crises necessitating the use of public funds has been diminished by the significant volume of regulatory and supervisory changes in progress. For this reason, we believe the test should be situations where the Bank might reasonably expect to have to trigger the SRR.

We welcome the decision to publish the draft MoU during pre-legislative scrutiny and will provide our thoughts on it at this time. We will take particular interest in how the MoU defines what should be regarded as a 'material risk' and how information will be obtained and shared amongst the respective parties. We would highlight however at this stage that we do see merit in the MoU specifying the creation of a 'COBRA' like committee comprised of the Chancellor and Governor (supported by HMT, Bank, PRA and FCA officials) to serve as a clear centre for the handling of crises. Such a committee should be established ex ante and undertake routine simulation to road-test its coordination and crisis management procedures.

We note that a consequence of the decision to form the Prudential Regulation Authority as a subsidiary of the Bank is that responsibility for the decision to trigger the Special Resolution Regime will rest, ultimately, in the same place as responsibility for the implementation of the resolution tools and powers. This is a significant departure from the existing arrangements and the current demarcation of powers and responsibilities. We would urge the Treasury to engage with the Banking Liaison Panel (set up to provide advice to the Treasury on the operation of the SRR) to ensure that appropriate safeguards are introduced to prevent both supervisory forbearance and unnecessarily early implementation of the SRR.

Special resolution regime

We support the changes proposed to the Special Resolution Regime, proposed in Clauses 60 to 62. Whilst we support the intent of the proposed change to the private sector reverse property transfer in part 5 of Clause 59 (S42A(4)) we note that the required consent must also apply where property has subsequently been transferred and is no longer owned by the original transferee.

The Prudential Regulation Authority

4. **Do you have any comments on the objectives and scope of the PRA, as described above and in Chapters 3 and 4?**

We support the general objective of promoting the safety and soundness of PRA authorised persons through ensuring that business is carried on in a way which does not adversely affect the financial system and minimises the impact of any failure on the stability of the UK financial system. These are sensible and important objectives that, if met, will help promote stability in the banking system. We are also supportive of the principle that the PRA will not be operated on a "zero failure" basis. This sends out the right message to the industry and removes the well-documented dangers of firms thinking they will not be allowed to fail. It is entirely consistent with the broad direction of travel of the reform programme pursued in recent years.

We agree with the notion that a rigorous and effective regulatory framework provides a strong platform for the financial services industry's sustainable growth and success. But we remain disappointed that the Government does not see a need for statutory provision relating to international competitiveness, innovation and growth. We therefore see a case for a renewed commitment to better regulation and the avoidance of gold plating and disagree with the assessment that innovation should not be a relevant factor for the PRA and FCA. This would appear to us to be entirely consistent with the objectives set for the three European Supervisory Authorities under recital 9aa of the Regulations applicable which require that in each case the authority should take due account of the impact of their activities on competition and innovation, global competitiveness, financial inclusion and the strategy for jobs and growth. The fact that the European authorities accept this makes the UK Government's reluctance all the more difficult to comprehend. International competitiveness, promoted through good regulation, encourages the presence of the key global institutions in the UK market.

It is important that the PRA will review its approach towards meeting its objectives. However, committing to review this "from time to time" is too ambiguous. It would be preferable to have further details on how frequently the PRA will review its objectives, and any other circumstances which would trigger such consideration. This would increase the ability of the PRA to take appropriate action in the event of unforeseen circumstances. We support the Treasury power to set additional future objectives for the PRA. This is an appropriate check and balance on the PRA's activities, and ensures the regulator's objectives can be changed according to future needs.

5. **Do you have any comments on the detailed arrangements for the PRA described above and in Chapters 3 and 4?**

We support the move to judgement-led regulation. It is important that any decisions the PRA makes must be in line with the individual circumstances of the firm, its position in the relevant markets and the economic conditions at the time. This will enable the PRA to have sufficient flexibility to make decisions based on the specificities of each case, rather than being hampered by a preset formula. We are pleased the Government acknowledges both that the quality of the PRA staff will be particularly important, and judgement-led decision-making will be rigorously evidenced based. It is vital these two principles will applied subject to a high standard and level of scrutiny in order to for the PRA to make successful judgement-lead decisions.

We appreciate the principles behind the Proactive Intervention Framework (PIF). We view early identification of risks to a firm's viability as a first step to making preparatory arrangements on appropriate remedial action and flagging to the authorities the need to prepare for failure and resolution of a firm. Although the document published by the FSA and the Bank of England does indeed provide more detail on how the PIF would work in practice, the problems highlighted in our previous response remain. With reference to the demarcated stages, once it becomes apparent to the market a particular firm has entered stage 3 and beyond, there is a high probability that it will have a further negative impact and increase the downward trajectory of the firm. Although this would theoretically not be

public information, in practice it is very likely the market will be aware of this, particularly if there were any changes to the composition of the firm's board.

We are pleased that the Government has decided to leave the Tribunal's scope of review of supervisory decisions unchanged since we disagreed with the initial assessment that appeals from judgement-based supervisory decisions should only be heard on the basis of a judicial review. There remain, however, concerns about the appeals mechanism on supervisory decisions given that that (when called upon) the Tribunal will no longer be able to substitute its own opinion for that of the regulator, leading to a potentially toothless review process. This represents a serious erosion of firms' rights to an independent review of contested decisions and we believe that it would be more appropriate for the Tribunal to retain the authority to overturn decisions with which it disagrees.

We are pleased the Government agrees that the PRA board must provide a robust challenge to the executive, and that the board will have a non-executive majority complimented by the right balance of expertise. We further note, from draft Schedule 1ZB that a majority of the members of the board of the PRA should be non-executive members and that for this purpose the Governor of the Bank and the Deputy Governors will not be treated as non-executive. Since the chief executive of the FCA will be counted as non-executive, this implies that there will be at least three Independent Non-Executive Directors on the board since this is the number required to place non-executives in a majority.

The Independent Non-Executive Directors will clearly have a major role to play and attracting candidates of the right calibre will be critical to ensuring that the statutory obligation on the PRA under Paragraph 3C of Chapter 3 to meet generally accepted principles of good corporate governance. We would not regard the chief executive of the FCA as being independent in part because of their membership of the Financial Policy Committee. This still leaves questions such as whether a senior independent director will be identified for the purposes of fulfilling the duties of the senior independent director under the UK Corporate Governance Code.

It is also of benefit the PRA will be legally responsible and accountable for its regulatory decision making, as established by the PRA being responsible for the exercise of its statutory functions and accountability to Ministers, Parliament and the wider public.

We are also pleased the PRA will have a duty to make and maintain effective arrangements for engaging with practitioners. However, the Bill states the PRA should "*make and maintain effective arrangements for consulting*". This is potentially ambiguous and it could be beneficial to have a more precise clarification on what 'effective' will mean in practice.

We understand why the Government believes it is unnecessary for the PRA to have a consumer panel, but would underline the importance of ensuring that it consults the FCA both to benefit from its expertise in consumer issues and to ensure that it does not undermine the FCA's objective. This arguably could strengthen cooperation between the two authorities.

Financial Conduct Authority

6. Do you have any views on the FCA's objectives – including its competition remit – as set out above and in Chapters 3 and 4?

The promotion of competition is to be a secondary duty: the FCA will be obliged to discharge its functions in a way which promotes competition, in so far as this is compatible with its primary objectives. This is appropriate, and in line with the secondary nature of

this duty the FCA is to have the statutory power to make an enhanced referral to the OFT when it believes competition issues merit further investigation and remedy. It would not be appropriate for the FCA – which is not an experienced competition authority – to have the promotion of competition as its primary duty. We expand further on the implications and risks of the FCA's competition duty in response to Question 10 below.

We note that the proposed FCA objectives do not refer explicitly to growth or innovation. It is important to remember that growth and innovation are important elements of both the strategic objective of market users' confidence in the UK financial system; and of at least two of the operational objectives: protection for consumers (including protection of investors' right to seek real returns and issuers' right to seek economic capital) and efficiency and choice in the market.

We comment as follows on issues arising from the proposed objectives based on the fuller picture provided by the FSA paper 'The Financial Conduct Authority: Approach to Regulation' (the FSA paper) published on 30th June:

- Paragraph 3.5 of the FSA paper makes the point that that the FCA will recognise that there are important differences between wholesale and retail markets but also that there are important links that could pose risks to confidence in the UK financial system. Paragraph 3.9 then explains that the duty to protect retail consumers will require a focus not only on firm's conduct to them directly, but also on the knock-on effects and adverse implications that may result from retail-related wholesale markets Chapter 5 expands upon this approach and this manifests itself in Clause 1C(2) of the draft Bill not requiring the FCA to consider whether the consumer is involved in retail or wholesale activities in determining the appropriate degree of protection for consumers. This potentially is a major departure from the existing approach in which there is a clear distinction in expectations for retail and wholesale customers and may sit uncomfortably with existing and new European conduct of business regulation.

- Paragraph 3.6builds on this by explaining that the term 'consumer' will in future be a broad one but nevertheless says that the FCA will recognise the differences across 'the spectrum' of this wide definition. What is clearly needed is a more detailed analysis of various current FSA Handbook glossary definitions (e.g. consumer, customer, banking customer) and how they might be affected in different ways by the FCA's regulatory approach. For example, the basis for differentiation between types of 'consumer' should continue to be the threefold classification under MiFID between retail, professional, and eligible counterparty. The distinction in paragraph 3.6 of the FSA paper between 'protection' and 'standards of conduct' is a good basis for distinguishing the obligations that should be owed to retail 'consumers' from those owed to others.

- We support the emphasis, in paragraphs 3.10 and 3.11, on the general principle that consumers should take responsibility for informed decisions. Paragraph 3.10 states that 'Information provided to consumers by the FCA itself, by the Money Advice Service…will also help'. Clause 1C2(c) of the draft Bill states that the FCA must have regard to information provided to the FCA, which appears to us to be a more significant direction than implied and we would be interested in understanding better how this would work in practice. Reliance on the integrity of the decisions of others is an essential plank of market confidence.

- We have no difficulty with the emphasis in paragraphs 3.12 to 3.15 and Box 2 of the FSA paper on the FCA applying its competition objective to: remedy asymmetries in market power and information; promote informed choice and market efficiency; and focus its action on particular identified market failures. But we would make the point that different approaches are required for wholesale and retail markets. In particular

regarding how the product information aspect could facilitate informed consumer choice. The intended intelligent analytical approach to the use of regulation to foster useful competition is welcome.

- Box 2 of the paper confirms that the FCA will not be an economic regulator in the sense of prescribing returns for financial products or services. The FCA's secondary 'competition duty' therefore should not translate into the FCA seeking to measure and mandate what the correct price of a product should be – and it would be entirely inappropriate for the FCA to make 'value for money' judgments that had this effect. We would like further details as to how the FCA will judge both whether competition is inadequate (please refer to our response to question 10) and how it intends to measure what the correct price of a product should be. PPI is a helpful example as the underlying process through the Competition Commission took several years to complete and is therefore a good illustration of how complex competition-related enquiries can become. Price intervention is a hugely powerful tool and we would be keen to have a much better understanding of the methodology around pricing analysis to enable us to make informed comment. This is particularly important when considering that innovation is driven both by consumer demand and the expectation that banks will make a real return on their research and development. A simplistic view of what the margin or price of a product 'should' be, will lead to a reduction in product innovation, supply and in extreme cases certain products may be withdrawn in both the retail and wholesale markets. Additionally if a product is sold to both a retail and wholesale consumer, the FCA must be clear that issues such as volume, credit risk etc will affect the pricing of the product differently between these two groups.

- The FSA has further said that it intends FCA to intervene where it is necessary to do so to ensure that its objectives are achieved, without undue detriment to consumers. As well as the objectives intended to guide FSA's use of its powers, our Members are concerned to ensure that it is clearly defined when FSA may or may not use those powers. An example is the power to ban a wholesale product which is causing problems for retail clients. If the intention of the product creator was that retail clients should not have access to the product, the mere fact that retail clients have gained access should not give rise to a ban, but be treated instead as a conduct of business issue. We would be keen to understand how the different levels of engagement with the supervision teams will be monitored to ensure consistent product intervention outcomes.

- The proposal to concentrate the FCA's regulatory resources relating to the integrity of a market on those markets which have a clear, direct and immediate link to wider confidence in the financial system, as set out in paragraph 3.18, and the general explanation of the FCA's approach to protecting and enhancing the integrity of the UK financial system in support of the Bank and the PRA's responsibily for financial stability would seem reasonable to us.

- We agree with the assessment, in paragraphs 3.21 and 3,22 that trade-offs between the interests of different market users are inevitable and that judgement will be an essential component of this. We would add that while trade-offs are inevitable they may change over time due to changes in the level of, for example, acceptable risk tolerance and we would therefore urge that judgements are reviewed on a regular basis. Our members would like to discuss this point further with the FSA and the fact that since trade-offs will occur both within and across different markets decisions will need to take account of the implications for all markets.

- It is clear from paragraph 3.25 of the paper that any form of kite-marking or product approval will not be contemplated. Potentially however, when considered in the round with other more proactive intervention powers, this might lead to very risk-averse

behaviours which in themselves can under-serve consumers generally. Therefore we would be keen to explore whether there are other means beyond product approval that give greater legal and regulatory certainty in an environment where the FCA itself acknowledges that it is possible that the FCA might make incorrect judgements. This would also give legislative force to the (acknowledged) requirement for the high level rules to be reasonably predictable in their application – enabling firms to operate based upon making reasonable judgements which will not be revisited with hindsight and giving necessary certainty to all stakeholders.

If the FCA is to have a wider remit going forward, for example assuming responsibilities relating to the Consumer Credit Act or the Lending Standards Board, full consultation with all interested stakeholders must be facilitated and appropriate transitional allowances incorporated into planning for any resulting change.

Although the FCA approach document has set out what will be undertaken by the FCA to achieve its strategic and operational objectives, it does not include any detail of what will happen regarding the responsibility for consumer credit regulation if this is transferred from the OFT to the FCA. Where the regulation does transfer to FCA, we assume the FCA objectives and approach will apply to this area of business but the rules would need to be appropriate for the specific risks entailed by such business: care will be required given that considerations for CCA-regulated lending must be different to savings, insurance and mortgages.

7. Do you have any views on the proactive regulatory approach of the FCA, detailed above and in Chapters 3 and 4?

As a general statement we would like to make it clear that our member firms wish to comply with FCA rules, to avoid a confrontational enforcement approach and antagonistic relationship between the regulated and the regulator, and to maintain the clear benefits of a co-operative approach in which regulator and firms work together to maintain good standards in the markets.

We welcome HMT's acceptance, in paragraph 2.100 of the Treasury blueprint document, that product intervention is unlikely to be appropriate in relation to dealings with professional and wholesale customers and not available for market integrity reasons, although it does not automatically follow that any failings are such that the product intervention power should therefore be focused on retail 'consumer' protection. In this context it will be important for FCA to consider whether or not a product is or is not targeted solely at wholesale customers, as noted under Q6; the mere fact that a retail customer gains access to such a product through a wholesale intermediary should be a conduct of business matter in relation to that intermediary, but should not lead to a ban on the product. We would welcome further consideration of how different definitions of customers might assist.

As the proposed FCA product intervention powers are substantial, we consider it important that the legislation is framed in a form that limits the possible circumstances for the powers to be used in an unintended way. In this context, we have the following comments on aspects of the proposed new powers:

- Product banning – the draft legislation provides for the normal rule-making process to be bypassed where the FCA deems it "*necessary or expedient*". We consider this language too wide and, consequently, open to inappropriate and possible over use. We consider that the FCA should normally follow the standard rule-making process and be permitted to abandon due process in extreme situations, for example where there is a risk of systemic issues arising It would therefore remain the case that a consultative process and the completion of an impact assessment would remain the

norm. As banning a firm's product would likely have a detrimental effect on the firm (or a number of firms), we suggest that temporary product intervention should be achieved using the usual 'supervisory notice' procedure (subject to adaptation to cater for intervention affecting a segment of the industry rather than a single firm). This would provide for an additional level of scrutiny over the FCA's decision-taking and ensure that best outcomes are reached. Whilst we can understand the reasons why the FCA has been tasked with producing guidance on how it will use its new powers we believe that it is important for the guidance to be drafted and consulted upon as a matter of priority in order to enable it to be taken into account as part of the scrutiny of the draft legislation.

- Other rules without consultation – the draft legislation generally permits the FCA or PRA to make rules without consultation where they consider that the delay caused by consultation would be detrimental to the interests of consumers. Similarly, such rules should only be made in emergency situations, based upon a broader balancing of the respective interests and risks. Such rules should be made only temporarily, with a proper consultation exercise following promptly.

- Publication of Warning Notices – we consider that regulators should be transparent and consistent in their decision-taking process. To further transparency, we suggest that the FCA's criteria and assessment process when determining (i) what; and (ii) when, to publish should be set out to expand on the provisions in the Bill, along the lines of the Banking Liaison Panel, established in accordance with the Banking Act 2009. Furthermore, in the interests of market clarity, we suggest that publicly disclosed information relating to Warning Notices should be accompanied by an explanatory statement, suitable for retail clients. This statement would ensure that retail clients correctly understand the meaning of such a notice. If this proposal is accepted then we would wish to see consultation on a draft as soon as possible.

Even though we remain doubtful of the merits of the proposed publication of disciplinary action (in line with our response to the MiFID review CP), we welcome the safeguards surrounding the powers of FCA on early publication of disciplinary action, and the obligation to consult the person to whom a notice is given. In this context it is important for FSA to take account of the trade-offs referred to in paragraphs 3.21 and 3.22 of the FSA paper. As the FSA acknowledges that balancing its objectives will be difficult, we are very concerned that the avenues to challenge the different interventions vary significantly. As a guiding principle would support strongly for any challenge process to be built into the resolution mechanism early, i.e. before a scheme or similar is developed. An important consideration in discussions between FCA and firms will be how the proposed publication of a warning notice will interact with any future settlement of enforcement action. In addition our members believe that a high profile notice of exoneration should be published where an entity was found to be without fault following an investigation.

At present the Financial Services and Markets Tribunal (FSMT) has the ability to supplant an FSA decision. Under the new regulatory structure the FSMT, however, other than with regards to *"disciplinary matters and those involving third party rights"* (White Paper Paragraph 2.66), it will lose this power and will only be able to refer the decision back to the FCA for further investigation. Overall we remain unclear as to why the Government considers that changing the existing role of the FSMT is required. We are concerned that this is being done at a time when a new philosophy of pro-active or judgment based regulation is being introduced, which is untested in practice, is acknowledged to require significant cultural change on the part of the regulators, and could have a substantial effect (and unintended consequences) for the workings of the market.

We welcome the confirmation given in paragraph 4.1 of the FSA paper that it is not envisaged that FCA's more interventionist stance will lead to a major change from FSA's

existing regulation of non-retail markets but refer you to our comments in question 6 on the linkages between non-retail and retail markets. We welcome the proposed intelligent analytical approach to determining whether risk is transmitted to retail 'consumers' from wholesale markets, set out in FSA paper paragraphs 4.6 and 4.7.

We also welcome the recognition of the need for consumer responsibility but believe that what this entails needs to be set out with greater clarity in statute.

8. What are your views on the proposal to allow nominated parties to refer to the FCA issues that may be causing mass detriment?

We would need a better understanding of who the nominated parties would be in order to comment further. In principle we are not averse to a scheme similar in structure to the 'super complaints' process under the Enterprise Act (2002) which has been used in financial services on a number of occasions and is now well-established, with explicit timeframes for action. Clearly, it is important that there can be no possible allegations of conflicts of interest so as a sensible precaution it might be helpful for the legislation to exclude any organisations that provide, promote or intermediate advice on financial services themselves from becoming a 'nominated party'. In fact we would see merit in the power to bring a 'super-complaint' being vested in a relatively limited number of bodies (one of which would be FOS, for example). We also see a need for the legislation to set out the criteria for the bringing of a 'super-complaint' and the provision of a statutory time limit for the FCA announcing how it proposes to deal with a complaint.

The FCA should also be placed under a statutory requirement to publish more substantive guidance on the 'super-complaints' process including the factors which it will take into account in determining whether to permit a 'super-complaint', the evidence which it would expect to be provided in support of a 'super-complaint' and the process it will follow in investigating a 'super-complaint'. We also see a case for this guidance being subject to consultation once drafted.

9. What are your views on the proposal to require the FCA to set out its decision on whether a particular issue or product may be causing mass detriment and preferred course of action, and in the case of referrals from nominated parties, to do so within a set period of time?

We are concerned that the proposal omits a critical issue. It is unclear whether "mass detriment" must be premised on the FCA considering that there has been some form of compliance failure (i.e. failure by firms to comply with the rules) or whether it could also arise from market failure (i.e. firms are complying with the rules but the market is not operating in a way that produces sufficient benefits for consumers). The distinction is critical because a decision that there has been "mass detriment" will create expectations as to the consequences that should follow, but firms selling products compliantly ought not to be subject to redress even if some form of action needs subsequently to be taken to correct behavioural or structural features in the market.

Equally, if the FCA's decision is premised on it deciding that there has been a failure to comply with the rules, then that decision must involve a suitable process. The same decision in the context of section 404, for example, would be preceded by consultation and could be challenged in the Tribunal.

In addition to requiring the FCA to set out its decision on whether a particular issue or product may be causing mass detriment and preferred course of action, we see a need for first, the need to be able to challenge and test the FCA's thinking around the underlying issue and second, statutory provision to bring greater coherence to the statutory regime. At present, there are four different statutory tests for consumer redress: three in FSMA

and one in DISP. We therefore see a case for the statutory regime to be strengthened in the following respects:

- To reinforce the role of the FOS of making decisions based on the circumstances of individual cases;
- To reduce the scope for protracted disputes that complicate the handling of complaints, by enabling decisions as to the appropriateness of a firm's business practices (affecting a large number of complaints/ potential complaints) to be referred at an early stage to the Upper Tribunal; and
- To incentivise CMCs to operate in a way that assists the resolution of genuine complaints, by enabling the FOS to impose requirements on CMCs as well as consequences where those requirements are not met.

10. Do you have any comments on the competition proposals for the FCA set out above and in Chapters 3 and 4?

The Government proposes to give the FCA a duty to "discharge its general functions in a way which promotes competition". As discussed in response to Question 6 above, this is preferable to the potentially more disruptive alternative of making the promotion of competition a 'primary objective' of the FCA. The existing formulation strikes a better balance by giving the FCA a competition duty but not requiring it to promote competition where this would be incompatible with other objectives. Members, however, still have significant concerns.

First, there is a need to balance the FCA's objective of consumer protection with its proposed duty to discharge its general functions in a way which promotes competition. Too much intervention will encourage conservative behaviour and discourage innovation, which in turn will discourage competition.

Second, poorly targeted interventions by the FCA on 'competition' grounds could give rise to concerns, not least in respect of the FSA's stated intention that the FCA should make 'value for money' judgements. Expert competition bodies conduct sophisticated, economics- and effects-based analysis before intervening, and use sophisticated tools including cost-benefit analysis to ensure that their interventions are proportionate. The FCA may not be as well placed as those more experienced bodies to judge whether a competition-based intervention is appropriate. Further, 'value for money' is a difficult concept to regulate, not seen by sophisticated competition or economic regulators as an appropriate target for competition law, and that there is a real risk that inappropriate use of the FCA's product intervention powers to try to secure 'value for money' may result in less choice.

Similarly, too great a focus on transparency and on price may lead to standardisation of products, the stifling of competition, and disincentives to innovate. Members are concerned that the FCA should not work towards a market with simple, highly comparable products in the mistaken belief that this will deal with both consumer and competition concerns. There is a risk that this will result in standardisation and commoditisation that will stifle competition and result in less innovation and more limited consumer choice

Third, as far as skills and expertise are concerned, if the FCA is to address competition issues it will need substantial relevant competition law expertise. It may be preferable for the FCA to recognise that there will be some limits on its expertise in this area and therefore to make use of its proposed powers to make an 'enhanced referral' of a matter to the OFT (or CMA as it is likely to become).

Fourth, members are concerned at the proposal to give the FCA a competition duty at a time when the future of other key institutions of the competition landscape is also very

uncertain. This situation unfortunately results in members being unable to understand holistically the regulatory regime in which it is proposed that they will have to operate. It would be preferable to have an understanding of the roles of the OFT or the Consumer and Markets Authority, and for those roles to have bedded down, before deciding on what role the FCA will also play in competition analysis and enforcement. The way the CMA and the FCA interact will in practice be crucial for the financial sector to understand and it is regrettable that there is such a high level of uncertainty.

Fifth, Paragraphs 3.13 to 3.15 of the FSA paper suggest that the FCA will see its competition mandate as going beyond behavioural features and extending to structural features. The limits of this are quite unclear: for example, could the FCA vary a firm's permission in the interests of advancing its efficiency/choice objective, so as to achieve structural changes to a particular market? The Treasury blue-print document (paragraph 2.115) suggests the FCA would have a discretion to refer a matter to the OFT, but it is not clear why it would need or want to do so. We are also concerned about the significant disparities in the legal processes and accountability mechanisms applicable to the FCA's use of its powers in this area as compared with those of the OFT and other competition authorities.

11. Do you have any views on the proposals for markets regulation by the FCA, described above and in Chapters 3 and 4?

We welcome the intention described in paragraphs 1.19 and 5.2ff of the FSA paper to establish a business and market analysis team, and to base the FCA's policy and practice on such analysis. The value of this approach will depend crucially on retaining and recruiting high quality staff and ultimately the methodology it might choose to adopt (see above). We would suggest that the Client Asset Sourcebook Risk team (CASS team) could be the model the FCA uses for this team and other specialist teams within the FCA.

Indeed the FSA notes that the ethos of the CASS team embodies the FCA's ethos of pre-empting risk through a proactive, intrusive approach and a willingness to intervene early before detriment occurs. Our members are supportive of this. But we would add that the resources dedicated to the CASS team will need to increase so that firms can obtain quicker responses to enquiries so as to not detriment users of the market. Delays in regard to bank's requests and questions could have significant implications, particularly in times of economic stress.

As regards the creation of other specialist teams such as the business and market analysis team and those dedicated to other specialist areas under the new approach to regulation there will need to be sufficient resources allocated to these teams to ensure they can fulfil their research function effectively.

Members are, however, concerned at the FSA's stated intention that the FCA should make 'value for money' judgments. Neither competition authorities nor specialist economic regulators make such judgments. There is a real risk that inappropriate use of the FCA's product intervention powers in order to achieve 'value for money' may result in less choice. As far as we are aware it is not intended that the FCA be a price or economic regulator.

Using the more detailed explanation provided in the FSA paper as a means of commenting specifically, we welcome:

- The broad risk framework described in paragraphs 5.6 to 5.9. In particular we agree with the focus on the probability, incidence, and severity of risks as the driver of resource allocation. We look forward to engaging with FSA as it develops the methodology summarised in paragraph 5.9. As part of this process we would like to

discuss with FSA in more detail how it envisages measuring an appropriate 'culture' under the fifth bullet of paragraph 5.12.

- The commitment in paragraph 5.17ff to 'significant continuity' with the FSA's current approach to market regulation.

- The priority which paragraph 5.23 envisages being given to engagement with Europe, particularly ESMA. Given: (1) FSA's expertise in wholesale market regulation; (2) the significance of wholesale markets to the proposed FCA objectives (3) the importance of ensuring that ESMA's rule-making and policy and supervisory coordination is consistent with those objectives; (4) the importance of ensuring that ESMA's work is fully informed and influenced by appropriate differentiation between different markets and different types of 'consumer', and (5) the importance of imbuing ESMA with the policy and rule-making disciplines described in paragraph 5.33, we would like to understand in more detail how FSA plans to carry forward FCA's engagement with ESMA.

- The elements of the proposed policy- and rule-making function set out in paragraph 5.33, in particular the emphasis on market analysis, business model analysis, market failure analysis, understanding of commercial drivers, consultation, sensitivity to market impact, clarity of expectations, respect for firms' and consumers' responsibilities, and post-implementation reviews. These are all disciplines which, as noted in the previous paragraph, FCA should instill in ESMA.

12. Do you have any comments on the governance, accountability and transparency arrangements proposed for the FCA, as described above and in Chapters 3 and 4?

We welcome the confirmation in paragraph 2.129 of the Treasury blueprint paper and paragraph 4.17 of the FSA paper that the FCA will be obliged to investigate and report on regulatory failure since sensible use of the findings, complementing market failure analysis, is important to ensuring that scarce FCA resources will be properly targeted. We agree that the FCA should investigate situations where market failure has occurred and attempt to use this to learn lessons and implement remedies. However the team undertaking the investigation and drafting the report for HM Treasury and Parliamentary review should be operationally independent from the area on which it is reporting. Unless a separate team is charged with conducting a review the independence of this report could be compromised. In the interests of transparency and objectiveness our members believe that investigations of regulatory failure should be prepared by an independent body although measures would have to be implemented to take into account concerns regarding confidential information about firms.

We welcome that the FCA has the duty to investigate failures as prescribed in Section 51 of the draft Financial Services Bill. 51(1) and (2) succinctly details the circumstances in which the FCA is required to investigate and report to the Treasury. We note that the circumstances for a report include where events have not actually led to a "*significant*" negative outcome but "*could have had*". Therefore, the draft legislation has a concept of near misses where the FCA is required to initiate an investigation which we welcome.

We also welcome a statement of definition of a regulatory failure i.e. the failure of regulation to achieve the FCA objectives, the desired level of protection of market users and of the benchmarks of when the FCA has an obligation to report failures or 'near misses'.

We would also like to understand the process for the appointment of NEDS appointed other than by HMT/BIS and the definition of a NED.

Coordination and regulatory processes

13. Do you have any comments on the governance, accountability and transparency arrangements proposed for the FCA, as described above and in Chapters 3 and 4?

We welcome the statutory obligation for FCA and PRA to coordinate referred to in paragraph 2.139 of the Treasury blueprint document; the specific statutory obligations for the existence and content of the MoU between them described in Paragraphs 2.140 and 2.141; and the provisions described in paragraphs 2.142 to 2.145 on maintaining its content and public accountability for its use. As mentioned above, given the Bank of England's responsibility for payment systems, we consider that there should also be a MoU between the Bank and the FCA.

We note that in the blueprint document MoUs are repeatedly cited as a key mechanism in resolving concerns regarding co-ordination. As they are relied upon significantly, we encourage the MoUs to be developed as soon as practicable and subjected to public consultation. We welcome the proposal that regulators review MoUs at least annually and would recommend that this be as part of a consultative process.

Robust operational co-ordination will be essential to a coherent and efficient regulatory regime. Consequently, we look forward to publication by the Bank of England and FSA of plans on operational co-ordination later this year, as referred to in paragraph 2.136 of the Treasury blueprint document. Given the significance of these plans, it is important that the Bank of England and FSA consult publicly on this document.

Many member banks will have dual regulators, with objectives which in some cases overlap but in many cases are specific to the regulator. We would welcome a forum which allows members to report to regulators how effectively the regulatory teams from different authorities are working together and which enables them to highlight their concerns.

Finally with the creation of specialist teams, it is imperative that someone amongst the regulatory authorities has an overview and responsibility for overall co-ordination. Disjointed approaches amongst teams will lead to ineffective regulation. The FCA, for instance, has the ability to order firms to increase the asset quality of a covered bond offered to the market; since,, however, this will affect the capital position of the bank the PRA may also need to be informed of this decision upfront.

At the same time, we see as important the confirmation, in paragraph 2.79 of the Treasury blueprint document, that FCA will not be a 'junior partner' to PRA and believe that this commitment should guide interaction between the FCA and PRA where the latter proposes to use its power of veto.

14. Do you have any views on the specific regulatory processes involving the PRA and FCA, as described above and in Chapters 3 and 4?

The proposed process for approval of approved persons, in paragraph 2.160 of the Treasury blueprint document, appears to give primary responsibility for defining a Significant Influence Function requiring approval to the PRA, with the FCA capable of designating a SIF if PRA has not done so. FCA then appears to have the ability to remove approval from a SIF, or any other approved person, for 'egregious conduct'. Careful consultation between FCA and PRA will clearly be essential if confusion and contradictory decision-making is to be avoided.

We welcome the Government's commitment in paragraph 1.47 of the Treasury blueprint document for a simplified process on authorisation with one regulator taking the lead with processing an application. We encourage the Government to take a similar streamlined approach to the approved persons application process and variations in permission.

We also see scope for confusion and contradiction between the rules of FCA and PRA, as described in paragraphs 2.168 to 2.170 of the Treasury blueprint document, especially taking into account interactions with European rule-making bodies. In addition to consulting each other and ensuring consistency between their rulebooks, we would suggest that the FCA and PRA should also pursue the FSA's existing policy of 'intelligent copy-out'.

We support the view that where one group firm is PRA authorised, the PRA should be the prudential regulator for all group firms. We believe that this approach would assist in coherent prudential regulation of group firms. We consider that the alternative approach, potentially resulting in different prudential regulators for firms within a group, risks being disjointed. Such an approach would seem particularly necessary in light of the Government concluding that it would not be appropriate to require the regulators to put in place a single rulebook. It would seem inconceivable to require a group to need to comply with different prudential rules for firms within its structure.

We strongly urge that the FCA and PRA work effectively together ensuring that results from risk assessments by one body are used by the other without the need to go through the same process again. This would ensure joined up actions from both regulators.

The FCA has prudential regulatory responsibility for certain non-bank institutions. It is important that the split of prudential responsibility between PRA and FCA does not lead to the potential for risk arbitrage within the same country particularly within the shadow banking sector. It is important in this context for the PRA to make effective use of its ability to bring under its authority institutions it considers it needs to regulate in order to avoid such risk arbitrage and protect the UK economy.

We agree with the proposals, in paragraphs 6.11 to 6.13 of the FCA paper, on the importance of coordination among EU authorities in relation to FCA's and other UK authorities' interaction with ESMA and other EU authorities. Consistent negotiation in the EU on the basis of inclusive discussion with interested parties is essential for effective rule-making for wholesale markets.

The development of a clear, well informed and practicable UK view on European initiatives is clearly essential to the process of influencing new regulatory measures and rules at the formative stage. This is made all the more necessary through the European practice of requiring representation to be provided by a single lead authority. While the point is recognised, and appreciated, little has been related on how the regulators will go about ensuring they have good mechanisms in place for ensuring that UK representation around the European table is second to none. In our earlier submissions we have suggested that consideration be given to maintaining a single international secretariat across the relevant authorities as a common shared service and the establishment of cross-authority teams to ensure that UK representatives at the three European Supervisory Authorities and other European and international committees are in a position to draw upon all relevant expertise and knowledge. We view this as a credible proposition meriting further thought.

We note that the Treasury blueprint document proposes a new s.166A FSMA, granting both the PRA and FCA a new power to appoint a skilled person to "*collect and keep up to date*" information where an authorised person has contravened a rule which requires it to collect and update information. Given this is a significant extension to the powers the FSA

has today under s.166, we would welcome further clarity regarding the conditions under which this would be used.

We do not agree with the proposal relating to the withdrawal of permissions as there are circumstances where a firm may want to retain its permission for commercial reasons (e.g. to enable it to re-enter a market without having to apply to the regulator for an extension). So long as the firm is prepared to pay the fee and comply with all regulatory requirements, it should be able to retain the permission. The current situation as regards notice of intention to withdraw permission and the right to appeal should remain.

FSCS and FOS

15. Do you have any comments on the proposals for the FSCS and FOS set out above and in Chapters 3 and 4?

We believe that the FSCS and FOS should be placed under a statutory obligation to publish annual plans and that they should consult on these and be audited by the National Audit Office. We therefore welcome the Government's proposals in relation to the FSCS which implement dual lines of accountability to both the PRA and FCA and supported by oversight from the National Audit Office.

We remain concerned however that the governance arrangements of the FSCS have not been sufficiently upgraded in light of the role played by the scheme in relation to a default by a deposit-taking institution. In particular, we strongly believe that the Government should put in place arrangements for an enhanced creditors' committee so that contributing institutions have a mechanism for ensuring appropriate representation in relation to the estate of a failed credit institution. Deposit-takers are currently in a situation in which they have to pay for the costs of default but are unable to influence in any material way the process and procedures for realisation of the assets of the failed institution's estate.

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

British Bankers' Association
8th September 2011

ANNEX 1: Macro-prudential tools

The table below summarises the strengths and weaknesses of a number of possible macro-prudential tools. It draws on the experience of our members who have encountered a number of these tools during their operation in some of the Asian markets.

Tool	Strengths	Weaknesses
Counter-cyclical capital buffers	• Can reduce overall lending • Build a cushion that can be drawn down during a downturn in the economic cycle • Basel III envisages reciprocity agreements to deal with concerns of cross-border leakage	• To reduce overall lending, banks may choose to lend less to socially beneficial areas, and maintain lending to lucrative but risky sectors • Buffer can be undermined by additional capital raising by banks, arbitrage and cross-border lending and lending by non-banks • Too blunt an instrument, may stunt growth • Drag on banks' return on equity (ROE), which may encourage risky behaviour to maintain ROE
Ante-cyclical asset class-specific capital adjustment, through systemic changes to risk weightings	• Build buffers against losses on risky loans • More targeted than system-wide measures, thus likely to be more effective • Can be implemented by asset class-specific adjustment of the Basel II scaling factor	• Difficulties of categorising 'risky' sectors • Does not address lending to specific sectors by non-banks
Expected loss provisioning	• Builds cushion that can be drawn down during a downturn in the economic cycle • Creates perception of systemic prudence	• Future losses are hard to estimate, could lead to inefficient allocation of banks' capital • Potentially misleading if badly estimated and may encourage moral hazard assuming there is protective cushion for the downside
Dynamic provisioning	• Looks further forward than expected loss provisioning, i.e. through the cycle	• Distorts financial statements as it applies to business not yet on the balance sheet • Does not reflect the remaining life of assets on the balance sheet
Variable liquidity ratios	• Reduce overall lending • Mean that cash and other liquid assets are available when a crisis hits	• Inefficient use of liquid assets that could be used more productively • Very costly for banks, thus could have negative impact on the financial system and the economy • May encourage risk-seeking behaviour by banks to maintain ROE • Liquidity metrics for micro-

		prudential regulation will not be properly calibrated for some time
Reserve requirements	• Reduce total volume of lending by requiring banks to hold more deposits at the central bank • Easy to implement	• Not effective when banks have other sources of funds than deposits, or if reserves are already high • Not the most efficient use of finance • Reduce overall lending but not necessarily risky lending
Haircuts on repo agreements & margin requirements on equities or other instruments	• Could reduce the pro-cyclicality of margin requirements • Can target provision of liquidity from the shadow banking sector	• Difficult to implement • Easy to circumvent • Can indirectly constrain leverage by increasing the cost of capital
Limits on currency mismatches	• Limit default if local currency suddenly fluctuates	• Prevent access to potentially cheaper finance thus preventing financial development and efficiency
Loan quotas	• Redirects overall lending	• Require tight regulatory oversight • Difficult to enforce, especially in a market with too many credit providers or sophisticated credit markets • Distortion of the lending process
Loan-to-value (LTV) caps	• Reduce lending to risky sectors thus preventing the build-up of systemic risk • Limit speculation as speculators need more equity and face lower returns • May limit the risk of property bubbles • Intervention s targeted; thus quite effective and with limited side-effects • Easy to implement and tweak according to developments in the market without losing credibility	• Difficult to implement in a financial system with large shadow banking sector, non-bank credit providers, or deep credit markets • Can be circumvented by borrowers topping up their mortgages with other personal loans • Potential for policy errors • May be perceived as discriminating against less wealthy people so polemically challenging • Less relevant for private banking but disrupts their activities
Debt-to-income (DTI) caps	• Only qualified borrowers get access to credit • Less reliance on asset collateral	• Can be pro-cyclical, as personal income correlates with economic cycle • May not prevent defaults in downturn for borrowers who suddenly find themselves out of a job
Property taxes	• Increase holding cost of property or transaction costs, thus limiting demand	• May discourage home ownership for less privileged
Prohibitions on risky products	• Direct limit on leverage	• Can be circumvented by taking out loans in different buyers'

(e.g. , multiple mortgages by the same person)		names • Interventionist, may encourage corruption
Caps on a single counterparty or asset-class exposure	• Direct limit on risk exposure • Limit on concentration risk	• Could be seen as a form of directed lending • Inefficient allocation of resources in case of policy error

ANNEX 2: CRD IV and national discretion to impose additional requirements

CRD IV provides Member States with a number of options through which to impose prudential requirements over and above the minimum.

Pillar 1

Retail exposure risk weightings

A119 (2) of the draft Regulation gives national supervisors the ability to review the risk weightings for real estate lending and mortgages secured by commercial and other property in its jurisdiction and to set a higher risk weight or stricter criteria on the basis of financial stability considerations. The EBA is directed to develop technical standards specifying the conditions which can be used to justify higher risk weights and the national regulator is required to consult the EBA before applying the higher standard. There is a cross-border reciprocity requirement under A119 (3).

Countercyclical capital buffer

A126 (3) (c) of the draft Directive, gives national competent authorities (the FPC in the UK) the ability to define variables against which to calculate the countercyclical capital buffer rate (the other criteria being a credit to GDP formula and any standard designated by the ESRB). A126 (4) stipulates that if a Member States uses this option, it must notify the EBA and ESRB the portion of the buffer which relates to this variable. They then assess whether the risks relate to financial stability and consider the impact on the internal market. A126 (5) gives the FPC the power to set a countercyclical buffer in excess of the 2.5 per cent maximum specified in Basel III. The reciprocity arrangements for institutions based outside the jurisdiction do not apply to the additional elements of the buffer linked to the additional criteria in A126 (3) (c) or any additional buffer above 2.5 per cent.

Pillar 2

A95(1) of the draft Directive permits national supervisors to use the Pillar 2 process to impose a wide range of measures, including additional capital, when ‘a certain type of institution is or might be exposed to similar risks or pose similar risks to the financial system’. The text particularly identifies the geographical location of exposures and business model (A94 (1)(h) & (i) as reasons for doing so. If the supervisor chooses to use this power it must notify the EBA which is under a duty to ‘monitor supervisory practices and issue guidelines to specify how similar risks should be assessed’ (A95 (2)). This broadens the existing Pillar 2 process which has until now focused on individual institutions rather than groups of institutions. It might be possible for the UK to use this flexibility to impose the ICB surcharge.

Macro-prudential flexibility

In addition to the specific powers above, the Commission also argues that there should be a mechanism to temporarily modify the single rule book to apply more stringent rules for macro-prudential purposes. It notes, ‘the Commission could adopt a delegated act increasing for a limited period of time the level of capital requirements, the risk weights of certain exposures, or impose stricter prudential requirements, for all exposures or for exposures to one or more sectors, regions or Member States, where this is necessary…in particular upon the recommendation or opinion of the ESRB’ (Explanatory Text 5.1).

September 2011

HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Dear Sirs

BIBA's response to HM Treasury consultation *A new approach to financial regulation – the blueprint for reform*

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

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

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

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

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

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

BIBA's response to the consultation questions

BIBA welcomes the opportunity to respond to the consultation paper and our comments are restricted to the questions relating to the FCA.

6 Do you have any views on the FCA's objectives – including its competition remit - as set out in paragraphs 2.80 to 2.90 and in Chapters 3 and 4?

BIBA's response: We support the proposed strategic objective and three operational objectives. We also believe that the competition remit is appropriate. We remain apprehensive about the use of transparency as a regulatory tool and still seek assurance that the new powers will contain the necessary safeguards to ensure an appropriate balance between the interest of consumers and regulated firms.

7 Do you have any views on the proactive regulatory approach of the FCA, detailed in paragraphs 2.91 to 2.110 and in Chapters 3 and 4?

BIBA's response: We concur with Government's view that product intervention should complement and not be a substitute for a regulated sales process. Furthermore we welcome the decision to make explicit in legislation that the FCA may not use this power to advance the market integrity objective without the provision of order-making powers given to HM Treasury. We repeat here our support for the proposed new power to direct firms to withdraw misleading financial promotions and to then publicise that the fact that it has done so as we believe this is an area that could benefit from such intervention.

8 What are your views on the proposal to allow nominated parties to refer to the FCA issues that may be causing mass detriment?

BIBA's response: We welcome attempts to identify and manage situations of mass consumer detriment and believe the proposals to allow nominated parties to refer such issues to the FCA to be appropriate.

9 What are your views on the proposal to require the FCA to set out its decision on whether a particular issue or product may be causing mass detriment and preferred course of action, and in the case of referrals from nominated parties, to do so within a set period of time?

BIBA's response: We are a little nervous about this proposal. If the expectation is for the FCA to investigate a referral from one of the nominated parties, it ought to be required to confirm whether a particular issue or product 'is' causing mass detriment, not just 'may be' causing mass detriment. The timeframe should allow for this nuance.

10 Do you have any comments on the competition proposals for the FCA set out in paragraphs 2.111 to 2.119 and in Chapters 3 and 4?

BIBA's response: We broadly support the competition proposals. We believe the power to initiate an enhanced referral to the OFT and the outlined two tier model for competition scrutiny are appropriate.

11 Do you have any views on the proposals for markets regulation by the FCA, described in paragraphs 2.120 to 2.123 and in Chapters 3 and 4?

BIBA's response: We have no view on these paragraphs.

12 Do you have any comments on the governance, accountability and transparency arrangements proposed for the FCA, as described in paragraphs 2.124 to 2.132 and in Chapters 3 and 4?

BIBA's response: We welcome the proposals concerning the FCA's governing body. We also welcome the putting of the Smaller Business Practitioner Panel onto a statutory footing. The proposals on accountability and the investigations and reporting duty are also supported.

13 Do you have any comments on the general coordination arrangements for the PRA and FCA described in paragraphs 2.138 to 2.149 and in Chapters 3 and 4?

BIBA's response: We are pleased that there will be a formal and transparent coordination between the PRA and the FCA as we believe this to be critical. We look forward to sight of the draft version of the MOU. We welcome the plans for enhanced accountability for effective cooperation and coordination as outlined in the paper. It will be important that this also reflects the work that will be undertaken at European level. With the PRA representing the UK within EIPOA, cooperation and coordination will be paramount on conduct issues such as the revision of the Insurance Mediation Directive. We remain concerned about the use of the veto and will watch that it is not used in a manner detrimental to the interests of the majority of firms who are not PRA regulated.

14 Do you have any views on the detail of specific regulatory processes involving the PRA and FCA, as described in paragraphs 2.150 to 2.195 and in Chapters 3 and 4?

BIBA's response: We welcome the decision in respect of authorisation. The passporting proposals seem sensible. We support the decisions on rule-making and waivers. We remain concerned about the proposals in respect of unregulated holding companies though are somewhat comforted by the comment this tool would not be for 'day-to-day' use. We support the three changes to assist with investigations and the proposals in respect of enforcement. .

15 Do you have any comments on the proposals for the FSCS and FOS set out in paragraphs 2.196 to 2.204 and in Chapters 3 and 4?

BIBA's response: We welcome the proposals relating to the operating model and coordination mechanisms for both bodies. We also believe the proposals on how to deal with issues that cause large-scale consumer detriment to be appropriate.

bvca The voice of long-term investment

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8 September 2011

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

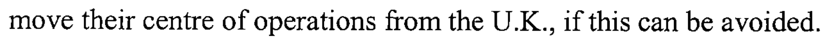
Dear Sirs,

Re: BVCA Regulatory Committee response to Her Majesty's Treasury Consultation: the blueprint for reform (CM8083)

This response to HMT's consultation on a new approach to financial regulation: a blueprint for reform is made by the British Private Equity and Venture Capital Association ("BVCA"). The BVCA represents the overwhelming majority of UK-based private equity and venture capital firms.

Most BVCA full member firms act as investment managers and/or investment advisers and are authorised by the Financial Services Authority. They will, in common with all other authorised firms, be affected by the proposals for reform. It is our expectation that all of our member firms will be regulated by the FCA.

We are restricting our comments on the legislation to two areas which we believe are important. The first because we believe that it has implications, which have not yet been considered, for the position of investment managers. The second because we believe it has a potentially damaging implication for the perception of the UK as a place for a European private equity firm to have its head office. We are deeply conscious of this issue at present because of the forthcoming Alternative Investment Fund Managers Directive ("AIFMD"), which we know is causing many firms to consider both their own locations and the locations of their funds etc. Some European jurisdictions (in particular Luxembourg) are actively promoting themselves as the place for AIFMD managers to be based. We are keen to ensure therefore that there are no other issues, outside of the AIFMD, which could influence firms to



move their centre of operations from the U.K., if this can be avoided.

Unregulated holding companies

The White Paper now contains some detail about the proposed power for the PRA and the FCA to impose requirements on certain parent undertakings of UK authorised firms. Our understanding of the provision is that this power may be exercised in relation to certain parent undertakings of any authorised person which is a body corporate incorporated in the UK which is either:

- authorised by the PRA; or
- an investment firm.

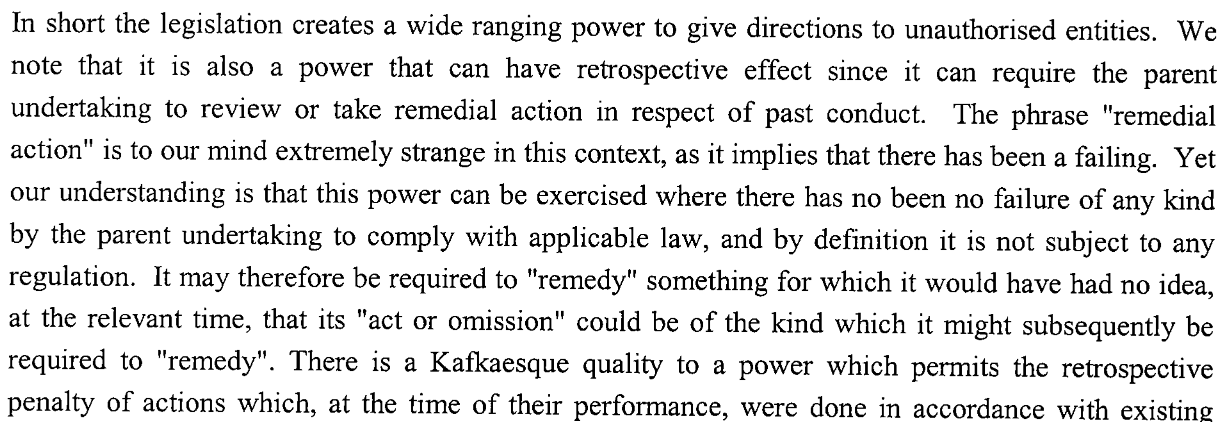
In practical terms the power relates to the vast majority of authorised firms including investment advisers, investment managers and brokers.

The power to give directions may be exercised only over a parent undertaking which is a body corporate incorporated in the United Kingdom which is not itself authorised.

Whilst it appears to be a condition that the parent undertaking is a 'financial institution' of a kind prescribed by the Treasury by order, we note that:

- the Treasury has power to omit the word "financial institution", so that the power could be applied to any UK corporate; and
- there are no indications as to the type of institution that may be prescribed by the Treasury as a 'financial institution'.

We note the provisions of S.192B(6) of the legislation which require the regulator to "have regard to" the desirability and practicability of using the power. However, this is not a sufficiently high threshold to prevent this power becoming used as a standard regulatory tool. In addition, the terms of Condition D at Section 192B offer little comfort as this permits the use of the power when a regulator considers that the acts of a parent are having or *may have* an effect on the regulation of an authorised person – there is no requirement for the acts of a parent to in fact have had an effect or indeed for the regulator to have reasonably formed its opinion.



In short the legislation creates a wide ranging power to give directions to unauthorised entities. We note that it is also a power that can have retrospective effect since it can require the parent undertaking to review or take remedial action in respect of past conduct. The phrase "remedial action" is to our mind extremely strange in this context, as it implies that there has been a failing. Yet our understanding is that this power can be exercised where there has no been no failure of any kind by the parent undertaking to comply with applicable law, and by definition it is not subject to any regulation. It may therefore be required to "remedy" something for which it would have had no idea, at the relevant time, that its "act or omission" could be of the kind which it might subsequently be required to "remedy". There is a Kafkaesque quality to a power which permits the retrospective penalty of actions which, at the time of their performance, were done in accordance with existing

legislation.

The uncertainty created by the proposed power is significant. The lack of certainty about the use of the power makes it impossible to know how to plan or indeed what to say to investors. It is relevant for BVCA member firms, for two reasons. The first is that some of them invest their funds under management in FSA authorised firms. The second is that the firm may itself be part of a group with a corporate parent, including where the corporate parent is itself a listed company.

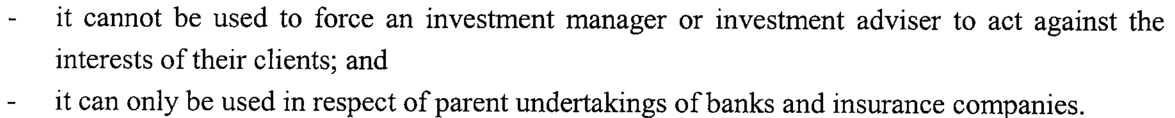
The White Paper now gives examples of how the power might be used, and we note that this includes directing the parent undertaking to provide additional capital or liquidity to the authorised firm. We consider that the regulators have adequate power over authorised firms to impose own initiative variations of permission which effectively restrict the authorised firm as to the way in which it may carry on business and enables the regulators to place other requirements and limitations on a firm's ability to carry on business. We see no need for this additional power, and we see significant dangers where this power is used to force a fiduciary to take decisions which are not in the interests of its own investor clients.

In a structure established by an investor (whether or not a private equity firm) to invest in an authorised firm, there will almost inevitably be one or more holding companies between the investing fund and the authorised firm. These companies may (but need not) be incorporated in the U.K. The effect of the power as drafted could in substance be to force an investment manager, which has fiduciary and regulatory duties to the investors whose money it manages, to put further investment into an authorised firm, where it would not otherwise, in the exercise of its discretion, choose to do so. Apart from the fact that it is not clear that such a power of direction to a fund manager would enable the fund manager to act consistently with its other regulatory duties (including those which will be applied to it under the Alternative Investment Fund Managers Directive) we believe the proposal to be unnecessary in this context for the reasons given above.

We also note in passing that it creates yet another perverse incentive to establish investment structures through non-UK entities (such as Luxembourg companies, a structure commonly used), which itself has the related effect of gradually shifting the centre of focus away from the UK.

If the power is to exist then it should be directed at those situations where the capital position of the authorised firm could have a direct negative impact on consumers. We therefore draw a distinction between banks and insurance companies and other firms. Consumers are directly exposed to banks and insurance companies because their rights (to a return of their deposit or to the payment out on an insurance policy) are only contractual rights against the institution, and their fulfilment depends upon the institution's solvency. We contrast this with the situation where a customer's assets are held in custody, in which case he is protected on an insolvency of the firm, because his claim is against the assets held in trust, and not directly against the firm.

In short we therefore consider that the power is not required, given the range of powers that can be used against authorised firms and that, if it is retained, it needs substantial amendment to ensure that:

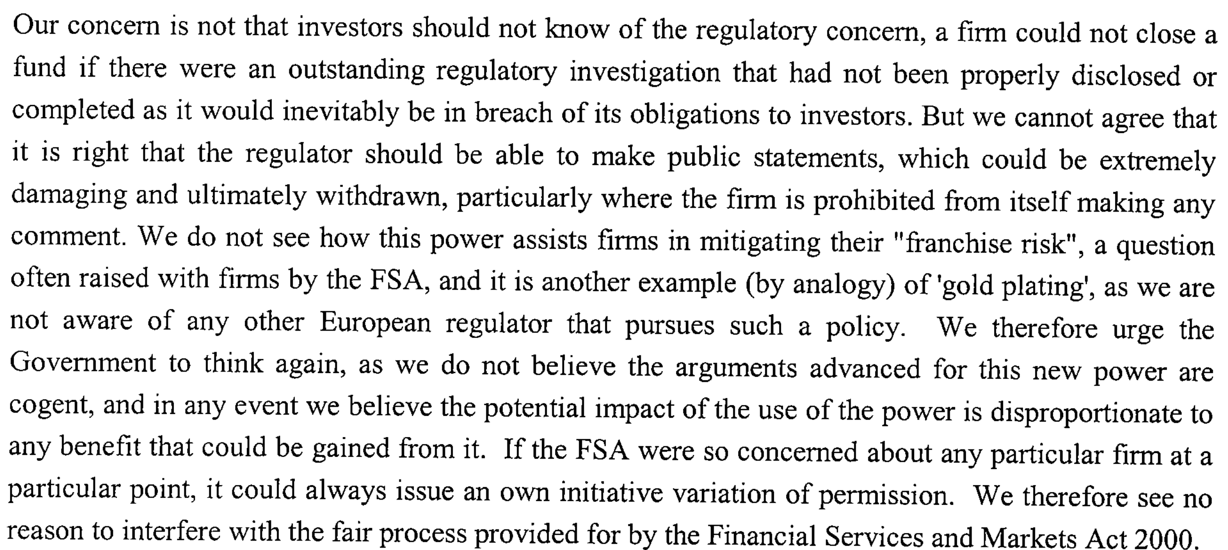


- it cannot be used to force an investment manager or investment adviser to act against the interests of their clients; and
- it can only be used in respect of parent undertakings of banks and insurance companies.

Revisions to enforcement powers

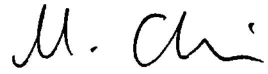
We note with concern the move towards the publication of warning notices. Whilst to date we are not aware of any enforcement action against a BVCA member, and we hope that this will continue to be the case, the philosophical shift concerns us because it could have serious and unjustifiable impacts on the ability of a firm to continue in business or an individual to retain or obtain employment. We do not believe that the public (or indeed investors) would appreciate the difference between a Warning Notice and a Final Notice and we are aware that Final Notices can and do differ significantly from those contained in the preceding Warning Notice. The Warning Notice is issued at a time when there has been no "independent" assessment of the evidence, nor has the firm or individual had any access to material held by the regulator, which may in fact assist it in its case. We also understand that proceedings may be discontinued after the Warning Notice stage.

If a private equity firm were issued with a public Warning Notice during a fund raising period this would amount to a de facto public censure at a very early stage in the investigation and enforcement proceedings. It would have the potential to be extremely damaging to the firm and would tarnish its reputation in the eyes of potential investors, and we do not believe that this would be mitigated by the Warning Notice either subsequently being withdrawn or a Decision Notice being substantially different. Under this proposal investors would see potentially groundless allegations made against the firm, at a time when the firm has had no opportunity for a proper 'independent' analysis of the case. Nor does the legislation permit the firm to explain its position to investors. It has to sit and watch its reputation being potentially destroyed by allegations which it may believe are not properly based. A Warning Notice is not always followed by a Decision Notice and we know that even when they are they are often fundamentally different.



Our concern is not that investors should not know of the regulatory concern, a firm could not close a fund if there were an outstanding regulatory investigation that had not been properly disclosed or completed as it would inevitably be in breach of its obligations to investors. But we cannot agree that it is right that the regulator should be able to make public statements, which could be extremely damaging and ultimately withdrawn, particularly where the firm is prohibited from itself making any comment. We do not see how this power assists firms in mitigating their "franchise risk", a question often raised with firms by the FSA, and it is another example (by analogy) of 'gold plating', as we are not aware of any other European regulator that pursues such a policy. We therefore urge the Government to think again, as we do not believe the arguments advanced for this new power are cogent, and in any event we believe the potential impact of the use of the power is disproportionate to any benefit that could be gained from it. If the FSA were so concerned about any particular firm at a particular point, it could always issue an own initiative variation of permission. We therefore see no reason to interfere with the fair process provided for by the Financial Services and Markets Act 2000.

Yours sincerely



Margaret Chamberlain
Chair - BVCA Regulatory Committee

HMT consultation June 2011– "A new approach to financial regulation, the blueprint for reform"

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

Summary

The BRC previously responded to the February 2011 consultation on the new approach to financial regulation; "Building a stronger system". The comments in this response should be taken together with its earlier comments in response to the February 2011 consultation.

BRC members providing financial services anticipate that under the proposed new regulatory regime they will be regulated by the FCA rather than the PRA. Whilst they strongly support the need for a fully coordinated approach to be adopted between the FPC, PRA and FCA, this response is limited to the proposals relevant to the FCA and other issues expected to be of direct relevance to BRC members.

A number of BRC members are currently regulated by both the FSA (for insurance mediation) and the OFT (for consumer credit). Others do not carry out insurance mediation and therefore are currently regulated solely by the OFT.

This response highlights the key points of principle for BRC members arising from the proposals on policy in the consultation. It does not comment on any detailed drafting arising from the draft Bill forming Chapter Three of the consultation document.

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Specific Comments

Q6. FCA's objectives. BRC members broadly support the overriding strategic objective and the three operational objectives, together with the new duty to promote competition unless incompatible with its strategic or operational objectives. If consumer credit comes within the remit of the FCA, BRC members believe that the objective of promoting efficiency and choice in the market will be particularly relevant to the consumer credit sector.

However, BRC members believe great care must be taken in how the FCA approaches its competition remit, and are concerned at the first indications from the FSA on how it views this remit. In particular, in the FSA's paper on its initial thinking on the FCA's approach to regulation, the FSA appears to be construing this remit as an argument for becoming a price regulator, making judgements about the value for money of products and considering the exercise of "its powers to take action where costs or charges are excessive" [in its opinion]. (Chapter3, Box 2).

It appears to BRC members that, whilst the FSA claims to acknowledge that "the FCA will not be an economic regulator in the sense of prescribing returns for financial products or services", this is exactly what it envisages doing. If the FCA determines what is or is not an unfair or excessive charge for financial products, it is effectively setting a benchmark as to what it does regard as a fair or acceptable level of charge. BRC members fail to understand the distinction between this, and acting as an economic regulator. They would welcome the Government's clarification as to how this differs from acting as an economic regulator, and confirmation as to whether the FCA should have the power to regulate prices by taking action if the FCA believes process are unfair or excessive.

BRC members would also welcome clarity from the Government on the interaction between the powers of the FCA to take direct action, and the remit of the new Competition and Markets Authority. BRC members believe that it is critical that there is a clear boundary between the FCA and CMA. They also believe that if the FCA has concerns as to whether prices or charges in any market or for any product are excessive (indicating a lack of competitive pressures) the FCA should refer those concerns to the CMA for investigation and action, rather than acting directly. The CMA will have greater expertise and specialism in competition related issues, and a wider economic and market overview.

Finally, BRC members retain a concern that the FCA is being established on principles based on the current regulatory sphere of the FSA, and fails to adequately consider the implications for the FCA should it also assume responsibility for consumer credit. Whilst this is more likely to present risks at the operational level than the strategic, the implications of the possibility that credit may also come within the remit of the FCA must be considered at all levels. This is commented in more detail in response to Q7.

Q7. Proactive regulatory approach of the FCA. As referenced above, the FSA's initial thinking on the approach to regulation which will be adopted by the FCA is driven by its past experiences in the markets it currently regulates. BRC members would welcome confirmation as to the level of input from staff with experience of consumer credit into this initial thinking. There remains a major concern that if consumer credit is transferred into a regulatory body which was established on principles derived solely from other markets, there is a high risk that it will not be fit for the purpose of regulating the consumer credit market. If regulation of credit is to be shoe-horned into an existing framework which was not specifically designed for the purpose it will inevitably create a sub optimum regulatory environment for consumer credit. BRC members fully recognise the difficulties of the decision as to the destiny of the regulation of credit, but believe final decisions on the approach to regulation by the FCA and its associated operational principles can only be reached once it is known whether it will be responsible for regulation of credit.

BRC members have significant concerns about the ramifications of the proposed approach to product intervention, unless there are extremely strong safeguards in place. BRC members do

not believe that the current proposals provide such adequate safeguards, or that the balance between consumer risk and prejudice to firms is correct. They are also concerned that the proposals appear to have been drawn up from a perspective that the affected firms will be large, relationship managed firms, and that the huge ramifications for smaller (usually contact centre managed) firms have not been fully considered.

In particular, the proposals do not seem to sufficiently recognise that for any firm that does not have the balance sheet strength, breadth of product portfolio and funding options of the major banks, any suggestion by the FCA that they may be considering product intervention is likely to be catastrophic. This is because:

- Smaller firms are more likely to be dependent on fewer product types, and therefore, each individual product is likely to be more material to its viability. Action on a single product will therefore have a larger impact than on a firm with a wider or more balanced product portfolio;
- Any adverse publicity to a specific product or firm will now inevitably lead to claims management company (CMC) and law firm campaigns targeted at recruiting potential claimants. The cost of handling volume claims may not be supportable for many firms. It is critical to recognise that there is a large cost even if the claims are unmeritorious. In particular, it will cost a firm a £500 fee to successfully defend a claim in the FOS, plus internal administrative costs. Accordingly, there is a high risk that firms that have done nothing wrong will be penalised and potentially forced out of business if there is any suggestion from the FCA that a product may have been mis-sold, is high risk, or may not be appropriate.
- In addition to potential claims, the impact of reputational damage or adverse publicity connected with product intervention on smaller firms is likely to be proportionately much greater than on large firms such as banks, and is likely to impact its wider trading rather than just the specific product.
- Whilst customer claims, reputational damage and customer dissatisfaction are major concerns, another critical risk is the impact on funders. This is particularly the case in the consumer credit market, where non bank lenders are usually dependent on wholesale funders for their funding. If such funders suspect that the FCA may be considering product intervention action against their borrower, it is likely that funding will be suspended or withdrawn. This is likely to lead to the collapse of the firm.

Given the potentially disastrous implications for smaller firms, and the economic consequences of business failure, it is critical that any product intervention action has extremely robust safeguards, including rights of appeal to an independent body and the conclusion of any appeal process prior to any publicity for the action. Accountability must also include the potential for financial redress by the FCA should they act improperly. BRC members are concerned that the current proposals carry too great a risk that premature or inaccurate publicity by the FCA before the extent and nature of any true customer detriment has been definitively established or assessed, and before the firm has had the opportunity to exhaust all safeguards, including if necessary judicial review. The current proposals, including the FSA's initial thinking on product intervention, do not provide sufficient safeguards, or achieve the correct balance between the interests of consumers and those of industry.

Similar concerns exist in relation to the proposals for publication of intended action on financial promotions, and of disciplinary action. Whilst the Government acknowledges the need for adequate safeguards, BRC members believe that it still underestimates the damage that could be caused to firms by adverse publicity. Any publication of concerns or intended action by the FCA against a firm could lead to irreparable reputational damage in the eyes of its customers, suppliers or funders. The business may collapse before it has had the opportunity to exhaust all safeguard procedures. For smaller firms the risks of this occurring are particularly real.

This clearly creates the real possibility that firms which eventually establish their innocence may nevertheless have suffered severe or catastrophic damage if the information on which the FCA

bases its initial judgements and its publications is flawed or incomplete, or the FCA has failed to follow due process. Any situation in which allegations by the FCA which have not been finally proved or adjudicated on are published "in the public interest" risks creating a public kangaroo court situation, in which the firm is effectively tried by media and inevitably found guilty. The same issues apply to individuals, who could suffer career ending reputational damage before they have been able to exhaust all avenues for challenging allegations against them.

Q 8 and 9. Mass Detriment. BRC members welcome the principle of certainty and transparency with regard to the process for identifying emerging risks. However, they regard it as critical that the process allows for sufficient engagement with industry, so that representations from industry are fully and genuinely explored. There are two critical issues to consider:

- Given the explosion in the claims management company industry, as described above, any regulatory intervention or identification of potential issues will now lead to major marketing campaigns by CMCs, recruiting potential claimants. This itself generates major costs for firms having to deal with increased complaint volumes, even where the complaints are unjustified. BRC members believe that the risks and costs for firms in having to deal with CMC driven complaints, and the change this has created in the wider market, are still severely underestimated by Government and regulators. The process for the FCA to set out its decision must ensure that full dialogue with industry has been exhausted, and there are no sudden shocks which could catch the market unaware.
- The FOS is a very subjective decision making body, adjudicating cases on the basis of what appears to an adjudicator to be "fair and reasonable in all the circumstances". This does not have to equate to what is legally correct. The process must eliminate the subjective element apparent in many FOS decisions and focus solely on cases where there has been a clear and objective breach of legislation or specific regulation.

Q10. Competition Proposals. The BRC member concerns as to the interpretation by the FSA/FCA of its role, and the risk that it becomes an economic and prices regulator by virtue of the way in which it applies its competition powers, are described in the response to Q6 above. BRC members believe that any concerns that prices are not being adequately controlled by competitive market forces should be addressed by the OFT and CMA following a referral from the FCA, rather than by the FCA itself.

Q12. Accountability and Transparency. BRC members welcome the Government's recognition of the importance of the safeguard provided by the Upper Tribunal as an independent reviewer of decisions of both the PRA and FCA, and the decision to leave unchanged the Tribunal's scope for review of supervisory decisions.

The BRC previously expressed grave concern at the lack of accountability of the FCA to Government. These concerns arise from the fact that regulatory policy and action by the FCA in the context of consumer credit has the potential to have major economic impacts by directly affecting the cost and availability of retail credit. Retail activity is highly dependent on the use of retail credit, particularly point of sale credit. Therefore the FCA will directly impact on the retail sector, the health of which is critical to the recovery prospects of the UK economy. The BRC therefore regards it as essential that the FCA is fully accountable to the Government for its actions and policies. The BRC welcomes the announcement by the Treasury Select Committee that it intends to conduct and inquiry into the accountability of the FCA to Government.

Q14. Specific Regulatory Processes. BRC members with a direct involvement in financial services are essentially retail groups, which include financial service providers as an ancillary to their core retail business. They would therefore welcome greater clarity on the scope of the power of direction in relation to parent undertakings, and the proposed definition of "financial institution" to which the power would apply. It would not be appropriate for the FCA to have any powers in relation to retail activities.

The question of authorisation of firms should consumer credit be transferred to the FCA is not addressed by the paper, but is a key one for BRC members. This was commented on in our previous response, but we would reiterate BRC member concerns as to the practical and logistical difficulties of new authorisations for all consumer credit licence holders, and the need for some form of grandfathering regime. This is a highly material issue in considering the resourcing of the FCA, and whilst the decision on consumer credit has not yet been made, the possible implications must be at least considered at this stage.

Building Societies Association

A New Approach to Financial Regulation: ***the blueprint for reform***

HM Treasury

Response by the Building Societies Association

Introduction

1. The Building Societies Association (BSA) represents mutual lenders and deposit takers in the UK including all 48 UK building societies. Mutual lenders and deposit takers have total assets of over £365 billion and, together with their subsidiaries, hold residential mortgages of almost £235 billion, 19% of the total outstanding in the UK. They hold more than £245 billion of retail deposits, accounting for 22% of all such deposits in the UK. Mutual deposit takers account for about 35% of cash ISA balances. They employ approximately 50,000 full and part-time staff and operate through approximately 2,000 branches.

Background

2. The BSA has responded in detail to the various consultations on regulatory reform so far, including *judgment, focus and stability*; *consultation on reforming the consumer credit regime; building a stronger system*; *product intervention; and the FCA operating plan* –

www.bsa.org.uk/policy/response/hm_treasury_newapproach_fin_reg.htm
www.bsa.org.uk/policy/response/response_hmt_bis.htm
www.bsa.org.uk/policy/response/building_a_stronger_system_response.htm
www.bsa.org.uk/policy/response/DP11_1
www.bsa.org.uk/policy/response/fca_operating_model.htm

3. We have also responded briefly to the consultation by the Department of Business, Innovation and Skills - *A Competition Regime for Growth: A Consultation on options for reform* www.bsa.org.uk/policy/response/competition_regime_for_growth.htm, and in full to the recent consultations concerning competition and choice in retail banking –

www.bsa.org.uk/docs/policy/ICB_BSA1.pdf
www.bsa.org.uk/docs/circularpdfs/7145.doc
www.bsa.org.uk/docs/policy/OFT_B2Ebanking.pdf
www.bsa.org.uk/docs/policy/prudentialandfinreg/BIS_HMT_Fin_priv_sector_ recovery.pdf

Summary

4. The BSA welcomes a number of developments; most notably –

- a series of helpful, high-level **regulatory principles and objectives** proposed in the White Paper and draft Bill, most notably efficiency, proportionality, consumer responsibility, transparency, promotion of competition, and co-ordination between the new regulators – it is important that the industry continues to work closely with the regulators and other relevant parties to help ensure that these principles are applied in practice

- the re-naming of the new conduct authority and strong assurances by the Government that **the FCA** will act fairly and impartially

- the acceptance by the Government of a continued **'single gateway'** for authorisations and certain other regulatory functions, which will be welcome at a practical level to dual-regulated firms

- a commitment by the Government to address the handling of **'mass claims'**

5. Nevertheless, there are certain matters of outstanding concern including –

- **costs** of the migration to a twin peaks model, especially those related to regulatory IT systems – the latest impact assessment revises the 'best estimate' of total costs from £400million to *£770million* and we would appreciate greater clarity about this matter

- continuing uncertainties about regulatory **accountability**, with the possibility of an 'all powerful' Bank of England emerging through the new regulatory architecture

- the need for careful planning to ensure that **smaller firms** are not disproportionately affected by regulatory burdens – and, more broadly, that the new FCA's approach to conduct of business regulation is effective, fair and proportionate

- the importance of UK agencies adopting negotiating strategies with EU and international bodies that maximise the **UK's bargaining position**

- clarification, in due course, of how the proposed **'product intervention'** powers will work in practice

- concerns about the complexities of dismantling the **Consumer Credit Act** and porting it into the FSA/FCA Handbook – if the FCA is to assume responsibility, the BSA strongly believes that there should be a 'lift and shift' approach that minimises disruption for firms and consumers

- continuing concerns about certain aspects of the proposals regarding pre-publication of **warning notices**.

6. We are very pleased with the willingness of the FSA to work constructively with the industry to help ensure fair and effective regulation. We have recently had very helpful meetings with a number of FSA teams including conduct of business policy, conduct of business risk, redress, FSA Handbook teams etc and look forward to developing these relationships with FCA and PRA shadow teams

Questions and BSA responses

1. ***Do you have any specific views on the proposals for the FPC as described in paragraphs 2.6 to 2.24 and in Chapters 3 and 4?***

7. The BSA notes the development of the concept of the FPC as now set out in the White Paper, and that the Government continues to gather views on the issue of the balance between Bank and external members on the FPC (para 2.18). We support the qualifying of the FPC's financial stability objective and activities by reference to UK economic growth, as drafted in new section 9C. We welcome the setting up of the Interim FPC and its analysis of potential macro-prudential tools, leading to recommendations for the permanent FPC toolkit.

8. We repeat our previous suggestion that such analysis should include thorough back-testing using appropriate modelling. This should identify (within the limitations of any models) which tools, if used in known circumstances in the present or recent past, would have produced which outcomes. Such a process could be invaluable to help make wise use of these regulatory tools in future. In view of the stringent stress testing requirements now placed on firms (eg in respect of capital and liquidity), it would seem very odd if regulatory tools were not similarly subject to stringent testing.

2. ***Do you have any specific views on the proposals for the Bank of England's regulation of RCHs, settlement and payment systems as described in paragraphs 2.32 to 2.40 and in Chapters 3 and 4?***

9. Turning to the Bank of England, we note that the Government continues to consider the important question of improving the Bank's accountability, in the light of the very substantial concentration of power and responsibility within the Bank group – a concern that the BSA shares. We therefore look forward to the further specific proposals on the Bank's governance that are promised in paragraph 2.30.

10. As to systemic financial infrastructure, we generally support the consolidation of these responsibilities under the Bank by bringing in regulation of settlement systems and RCHs alongside that of the payments system. We do not comment in detail, as societies, while end-users of these various systems, are generally not clearing members.

3. ***Do you have any comments on:***
• the proposed crisis management arrangements; and
• the proposals for minor and technical changes to the SR Regime as described in paragraphs 2.41 to 2.44 and in Chapters 3 and 4?

11. The White Paper states that very few respondents commented on the arrangements for managing crises in the February consultation. The BSA did so, but our main comment appears to have been overlooked, so we repeat it below.
We said that the proposed MoU was a sensible idea, but that it should be subject to full consultation, and overlap with the existing SRR Code of Practice should be

addressed. We welcome the undertaking to publish the draft MoU during pre-legislative scrutiny.

12. The Memorandum will rightly focus *inter alia* on questions about the risk to, and possible use of, public funds. We have previously observed - in the context of the SRR and its Code of Practice – that it is not only public funds (taxpayers' money) that need to be protected. Funds held in the FSCS, or capable of being levied by the FSCS on banks and building societies, are not a "free good". They can be used either to finance a bank resolution or to pay deposit compensation directly.

13. Where used for bank resolution, choices made as to which SRR tools are used, and at what stage early interventions are or are not made, could affect the ultimate cost via the FSCS to banks and building societies. In this context, we very much welcome the recognition (on behalf of the future PRA) at paragraph 9 of the Bank of England / FSA paper of 19 May *Our approach to banking supervision* that deposit guarantee arrangements operated by the FSCS play an important part in reducing the impact of firm failure, and that surviving firms themselves will have to bear the cost of FSCS payouts. We therefore argue that such recognition should be given greater practical effect through the Bill, as follows.

14. Just as the Chancellor rightly protects the taxpayer interest, we argued that one of the authorities – perhaps the Bank – should also be tasked with minimising the recourse to the FSCS (whether as a resolution fund or as a compensation fund). Money drawn from the FSCS ultimately constitutes a "tax" on building societies, banks and their customers. And, on the principle of no taxation without representation, it is also time to upgrade the formal role that deposit-takers have in overseeing the conduct of any SRR interventions that use FSCS money. The FSCS should be made accountable to a creditors' committee in respect of any interventions along the lines of Bradford & Bingley and the Icelandic banks.

15. We agree with the minor and technical amendments to the SRR.

4. *Do you have any comments on the objectives and scope of the PRA, as described in paragraphs 2.46 to 2.61 and in Chapters 3 and 4?*

16. We agree that the scope of the PRA did not need further change, and that the boundary of systemically important investment firms that PRA will regulate can be based on designation criteria developed by PRA , rather than stated in the Bill itself.

5. *Do you have any comments on the detailed arrangements for the PRA described in paragraphs 2.62 to 2.78 and in Chapters 3 and 4?*

17. While the Proactive Intervention Framework described in more detail in the 19 May paper continues to be a sensible system and guide to fair and consistent intervention activity, we do share the concerns summarised at paragraph 2.63 that any attendant publicity could reinforce a downward spiral. The PRA needs to be clear – in practice, rather than in theory – how this risk will be avoided. Otherwise the remedy will be worse than the problem.

18. We greatly welcome the Government's sensible decision not to limit the scope of appeal to the Upper Tribunal, as stated at paragraphs 2.64 – 2.67. We

argued very strongly against any limiting in our previous response, as we believe that would be in breach of article 6 ECHR. We acknowledge that the course of action available to the Tribunal could be to remit the overturned decision back to the PRA to reconsider, rather than for the Tribunal effectively to substitute its own decision.

19. We also welcome the confirmation that the NAO will be able to conduct value for money studies of the PRA. This is all the more important in view of the already spiralling costs of the PRA resulting from the Bank's determination not to make do with the FSA's existing IT systems but to spend heavily on their replacement (for more detailed comments, see below in respect of the impact assessment).

20. While we welcome the retention of full consultation on PRA rule-making, the insistence on full scale CBA for rules based on EU Directives at the point of implementation seems to us a victory of form over substance. We therefore repeat here the points we raised on European policy making in our last response.

21. It needs to be recognised that much, perhaps most, micro-prudential policy (eg on capital and liquidity) is now settled at EU level with the UK having less and less room for independent manoeuvre. So - in future - at least as important as consultation and CBA on actual rules and guidance to be made by PRA, will be consultation (with CBA) on the agreed outcomes that the UK should seek from current and future EU regulatory initiatives, which will then inform the UK negotiating strategy.

22. This illustrates moreover a fundamental flaw in the FSMA consultation requirements which could have been foreseen before 2001, but is now even more manifest. Where, for instance, a piece of micro-prudential policy is agreed at European level by way of a maximum-harmonising Directive, and FSA has to implement this by way of making rules, it must still go through a pointless show of consultation even though the European legislation must be implemented without amendment or super-equivalence. But at the point where consultation and cost-benefit analysis might actually have added some value – i.e. before settling on the policy position which the UK would advance in European negotiations – there is no requirement to do so.

23. Since we made this point in response to the previous consultation, the issue has become even more clear cut. The majority of current FSA micro-prudential rules on capital and liquidity will be superseded by a directly-effective EU Regulation, the Capital Requirements Regulation, which will therefore not be implemented by FSA rules at all, and will in general not permit any superequivalence. So the consultation and CBA stage at rule-making, that the Treasury's response in paragraph 2.75 is so anxious to preserve, will simply fall away. And the appetite for European regulation to proceed by way of directly-effective Regulations to avoid national inconsistencies is increasing.

24. We continue to urge that this lacuna be addressed – we suggest as follows: there should be a standing requirement for the Treasury, PRA or FCA as the case may be, to carry out both consultation and cost-benefit analysis on any formal proposal for European legislation before deciding what initial negotiating position actually represents the UK national interest. It is at that stage, where negotiations are to follow, that decisions should be informed by the cumulative impact of regulation – not when it is too late to do anything about it. Moreover, informal soundings are simply not robust enough.

25. Question 5 deals with the arrangements for the PRA. We include in our response some observations about key aspects of the PRA's proposed approach as outlined in the 19 May paper, and we will communicate these also to the shadow PRA.

26. First, we agree that there should be baseline supervision of all deposit-takers, but – more importantly- that the intensity of supervisory engagement will relate to the degree of systemic stability risk posed by firm (overview, paragraph 12 and page 11). We strongly support the focus of supervisors on the "big picture", with a high materiality threshold, early intervention to reduce the risk of disorderly failure, and the involvement of senior people at PRA.

27. The BSA is however concerned at the proposals for disclosure of supervisory returns (Box 3, page 11) and it is particularly appropriate that we remark on this in the context of the Bill. FSMA (section 348) prohibits the disclosure of supervisory information, and this in turn reflect superior European law – the confidentiality obligations in the current banking directives. We do not see how these would permit the PRA to "publish returns", nor- incidentally – can we identify any amendments made by the Bill to section 348 that would purport to permit such publication. The correct place for such disclosures in any case is in the Pillar 3 framework – this should not be muddled up with the completely separate channel of confidential returns to the supervisor. We consider that this sets a dangerous precedent, which PRA will in due course regret.

28. We turn also to the question of the use of third party reporting to for instance verify regulatory returns (mentioned at paragraph 70). The FSA has already begun to increase the scope and extent of the use of section 166 of FSMA to demand such reports. Our members are concerned that this is proving an extremely costly habit, and are even more concerned that the habit may grow in the future.

29. The effect of using section 166 at present is to outsource significant regulatory costs from the FSA itself (as the firm has to pay for the report), and thus in effect conceal them. We argue that the total burden of regulatory costs can neither be controlled or scrutinised while this back-door route is used. We suggest one of the following routes to achieve better cost control and accountability in the use of section 166 -

> (i) routine section 166 reports should in future be paid for by the PRA – so the costs will come within its budget / outturn, and be scrutinised there (arrangements could be made for the costs of non-routine section 166 reports to be recovered from firms where related enforcement action follows within a stated period) ; or
>
> (ii) the external cost of any section 166 report demanded from a firm in one financial year should be offset against the PRA regulatory fees otherwise payable by that firm for the following financial year – again, perhaps with a saving where relevant enforcement action is in train.

6. Do you have any views on the FCA's objectives – including its competition remit as set out in paragraphs 2.80 to 2.90 and in Chapters 3 and 4?

10. Do you have any comments on the competition proposals for the FCA set out in paragraphs 2.111 to 2.119 and in Chapters 3 and 4?

- **General**

30. As the White Paper notes, there was broad support for the FCA's strategic and operational objectives, and this support included the BSA. It is particularly important, in order to help avert a repetition of the previous problems, that the new body has a single strategic objective, ie protecting and enhancing confidence in the UK financial system, underpinned by the specified operational objectives. It is not in the interests of consumers, business or the UK economy to have a situation where the financial services regulator is facing in different directions.

31. We strongly support the regulatory principles concerning efficiency and economy, proportionality, consumer responsibility, transparency etc. We have examined, and also broadly support, the proposals for practical delivery of the objectives set out in *The Financial Conduct Authority: Approach to Regulation* (June 2011), provided the FCA is conducting its activities in accordance with the regulatory principles mentioned above. This would represent a continuation of the, much improved, conduct of business regulation by the FSA. Continuity is very important – consumers, businesses and the economy could not cope with another long hiatus while the FCA revisited its operating model and strategies following its inception.

32. A further matter, which is essentially operational in nature, concerns the fact that the FCA's primary focus will be on preventing wrongdoing by regulated firms. The BSA supports this focus, but would also like to see a practical concentration on helping firms *get things right.* The use of practical arrangements, like more informal pre-consultations with industry bodies and the establishment of industry panel working groups could be useful in this regard. Early signs are very hopeful indeed that the FCA 'shadow' team at the FSA has this point on board.

- **"Consumer champion"**

33. Our only key reservation regarding FCA objectives was the continued description of the FCA as a "consumer champion". The BSA set out detailed reasons for our concern about this characterisation in our response to the CP, *Judgment, Focus and Stability.* In essence, the point is that a true consumer champion - by its very nature - is expected to promote consumers' rights only, and it has no duty to consider either consumers' responsibilities or the rights of firms. This sits uncomfortably with the role of an impartial regulator. The Treasury Select Committee described the characterisation of the FCA as a consumer champion as "inappropriate, confusing and potentially dangerous".

34. We note and welcome the change of name from CPMA to FCA and the clarification (in *Building a Stronger System*) about the FCA's consumer champion role and, in particular, the confirmation that the FCA will be an entirely impartial regulator from whom firms and consumers can expect fair treatment. In the light of the assurances in the last CP, we presumed there would be no objection to including a requirement in the forthcoming Bill on the FCA to be a fair and impartial regulator. It is disappointing that such an explicit clarification is not included in the Bill and, whilst the Government's assurances are welcome, an explicit statutory provision would put the matter beyond doubt.

- **Competition**

35. Regarding competition, the BSA responded to the consultation by the Department of Business, Innovation and Skills - *A Competition Regime for Growth: A Consultation on options for reform.* We support, in principle, the Government's plan to merge competition functions within one body on the basis of a single Competition and Markets Authority to ensure the flexible allocation of scarce public resource to competition issues as they emerge, and for the combined body to be a stronger advocate for pro-competition policy across Government, including in the delivery of public services.

36. As the BSA also stated in its response to *Building a Stronger System*, while we agree that the FCA should have a remit to promote competition, the regulation of anti-competitive behaviour should, in our view, be left to the competition authorities, including to any new, merged authority. In the interests of regulatory clarity, there should be an explicit dividing line between *promotion* of competition on the one hand, and *enforcement* of laws relating to anti-competitive practice on the other.

37. The FSA/FCA will be very busy in establishing a new regulator, while not only continuing with day-to-day regulatory work but also taking on significant new responsibilities (eg, as planned, for consumer credit). It really does not need an additional role as a competition enforcement agency. Arrangements whereby the FCA promotes competition but refers suspected anti-competitive practices to the relevant authorities are, in our view, the best way forward. Therefore, we support the conclusion in the White Paper (paragraph 2.115) that the FCA should have power to initiate an advanced referral to the competition authority but should not become a competition regulator.

7. Do you have any views on the proactive regulatory approach of the FCA, detailed in paragraphs 2.91 to 2.110 and in Chapters 3 and 4?

- **General and product intevention**

38. The BSA supports the FSA's aim to "intervene, earlier in the product chain if necessary, to anticipate consumer detriment and choke it off before it occurs". Appropriately focussed early intervention would benefit consumers and firms by reducing the risk of large scale product failures which damage the reputation of the financial service industry, harm consumer confidence and cost the industry large amounts in redress. However, most of the mischiefs dealt with in the product intervention consultation concerned *mis-selling* – we do not believe that there is enough clarity yet about the product mischiefs that are likely to be targeted under the new approach and would welcome further information about this matter. The FSA could usefully build on the table of indicators of potentially problematic product features that it has included in its recent product intervention papers.

39. In practice, the right balance will need to be struck between the greater use of regulatory powers to prevent consumer harm and allowing firms the freedom to develop innovative products and services. Therefore, we welcome the recognition, in paragraph 2.98, that the power must be appropriately safeguarded.

40. We agree that it would not be appropriate for the regulator to act as a gatekeeper for all products entering the market. This would kill product innovation,

be resource intensive and would give consumers the impression that products have the regulator's seal of approval. We believe that the regulator already has sufficient powers to effectively intervene in product development to reduce the risk of consumer detriment further down the line. The FSA's new and more intrusive supervisory approach using its existing powers is already paying dividends. The impact of this new approach should be properly assessed before seeking to introduce new product intervention powers and more rules.

41. We do not believe more prescriptive rules on product development would be appropriate. Prescriptive rules can be inflexible, slow to adapt to changing circumstances and can result in detrimental unintended consequences. High level principles and rules coupled with detailed guidance would provide clarity for firms on the regulator's expectations and flexibility over how those expectations are met. If new prescriptive rules were to be introduced we believe they should be applied in a risk-based manner, proportionate to the risks involved in the product.

42. There are a number of wider questions about product intervention; for example –

- what will it mean *in practice* for firms' product development – what specific arrangements will the FCA put in place?

- how will it fit with EU provisions that are 'maximum harmonisation' and the Government's commitment not to 'gold-plate' EU law?

- will it be possible for some firms to circumvent the product intervention mechanisms by re-locating offshore and passporting in and, if so, what can be done to prevent such practices?

- how can the FCA ensure compatibility of its product intervention power with its pro-competition objective?

- to what extent with the conduct of business regulator's statutory immunity have to be revisited in line with its more 'intrusive' approach and, in particular, greater involvement in products at an early stage in their development?

- will there be arrangements to provide feedback on the *outcomes* of major regulatory initiatives, parallel to the requirements in the draft Bill for the new regulators to conduct regulatory enquiries ?

Such important matters will have to be considered as the product intervention framework develops.

43. The FCA (and, probably, the PRA as well) should have arrangements to assess, after an appropriate period of time, how successful regulatory initiatives have proved to be - especially if the FCA is to have greater product intervention powers. For example, TCF was enforced quite rigorously, but there was little detailed public feedback or analysis of its overall impact. This was somewhat surprising, given the duration and scale of the TCF exercise.

- **New financial promotions power**

44. The new powers regarding financial promotions must be used with great care because appeal to the Upper Tribunal is available only after publication of the notice.

The acknowledgement, paragraph 2.105 of the need for safeguards, is welcome, but proposes little in respect of additional safeguards.

- **Early publication of disciplinary action**

45. Advance publication of warning notices risks a presumption of guilt and the BSA set out, in its response to *Building a Stronger System*, our concerns over firms' human rights. The White Paper acknowledges the industry's concerns, as well as support for the proposals, and seeks further views.

46. It is important to ensure, both in respect of the financial promotions powers and early publication of enforcement action, that the FCA has strong powers to act against wrongdoing by firms, whilst respecting the rights of firms to be treated fairly and not, in effect, to be presumed guilty. It will be important to ensure a level-playing field for 'systemic' and 'non-systemic firms', and a proper validation system to ensure fairness and consistency.

47. Much will depend on how the powers are used in practice, but a potential safeguard that should be explored is requiring clearance from the Regulatory Decisions Committee before the exercise of either of these powers in individual cases.

48. We also have concerns about 'regulation by speech' and guidance consultations, which we have communicated in detail in previous responses, but the White Paper is silent on these matters (however, while we note and welcome the fact that recently the FSA introduced a standard consultation period for the latter, we believe that there should be a *minimum* prescribed period). Firms are entitled to clarity. Furthermore, regulatory material sitting outside the Handbook and unreasonably short consultations are unlikely to be compatible with the FCA's forthcoming strategic and operational objectives.

8. What are your views on the proposal to allow nominated parties to refer to the FCA issues that may be causing mass detriment?

9. What are your views on the proposal to require the FCA to set out its decision on whether a particular issue or product may be causing mass detriment and preferred course of action, and in the case of referrals from nominated parties, to do so within a set period of time?

49. 'Mass claims' or 'wider implications (WI) cases' are complaints that could affect a large number of consumers or firms, the financial integrity of a firm or a common industry practice. The Financial Ombudsman Service has, in effect, been required to adjudicate on such matters even though they have been of, essentially, a regulatory or legal nature. Examples include pensions mis-selling, mortgage endowments, unauthorised overdraft charges and PPI.

50. FOS has done its best to adjudicate these matters on an individual basis but, where they are essentially of a 'mass' nature and concern broad rules or principles (eg of a regulatory or legal nature), FOS is not the ideal mechanism for dealing with them. Indeed, they are precisely opposite to what FOS was set up to adjudicate – ie individual complaints. The FSA and FOS recently discontinued the WI arrangements, which had been largely unsuccessful, replacing them by a co-ordination committee with FOS and the OFT.

51. The BSA is a very strong supporter of FOS. We believe that it carries out its role of adjudicating individual complaints effectively and, as far as such cases are concerned, we see no reason for change. WI cases are different.

52. Since its supervisory enhancement exercise and assumption of enhanced consumer redress powers (under section 404 FSMA), the FSA, and – following it – the FCA, is very strongly placed to deal with WI cases that are of a regulatory nature. Recently, the FSA has also been rigorous in sanctioning firms that had poor complaints handling processes. In addition, because of publication in recent years of relevant data, there is now considerable transparency about how different firms deal with complaints. Therefore, the BSA position is that the determination of principles behind WI cases should no longer be dealt with by FOS, but the FCA (if they are regulatory) and by the courts (in respect of legal aspects).

53. The White Paper signals further changes to the processes for dealing with WI cases and states *"The FOS should be able to focus on processing individual complaints on a case-by-case basis rather than having to lead the way on mass issues"*. The BSA strongly agrees with this statement. The White Paper canvasses some possible changes, but because the proposals are at a relatively early stage of development, they are not covered in the draft Bill. However, we support in principle the essential proposal (set out box 2.H on page 33), that the regulator should have a clear, transparent and fair process for determining whether or not complaints are of a 'mass' nature and then dealing with them, as appropriate, in a prompt and thorough manner.

54. We strongly support the suggestion that other parties should also have a clear statutory role in the process. As long ago as 2004, the BSA signalled concerns about the handling of WI cases. One of the main components of the 'N2 + 2' review of the FSMA was a joint consultation by the FSA and the FOS on when regulatory action should replace FOS decisions on individual cases, and on the possibility of appeals from FOS decisions. The BSA identified problems with WI cases and proposed practical solutions, but unfortunately no radical steps were taken – had the kind of arrangements we proposed at the time been developed and put in place, some of the problems since 2004 (eg regarding mortgage endowments and PPI) might have been significantly reduced.

55. In our view, any process to identify and deal with WI cases should –

- be as prompt as the rights of the respective parties allow
- be as transparent as commercial sensitivity or confidentiality permit
- take in an appropriate range of relevant information from interested parties, eg from FOS, consumer bodies, industry groups such as trade bodies and statutory panels etc
- impartially decide whether the issue is genuinely of a *'mass'* nature – the FCA should not be put in the position of having to apply relevant processes to trifling matters and to others that are not realistically of a 'mass' nature: we must not have unrealistic expectations of what a regulator can do in this area
- once they have identified a claim as 'mass' or WI, lead to the 'freezing' of complaints at FOS until the matter is resolved.

56. As the FSA itself acknowledges, the PPI cases are an example of failure to intervene promptly enough. We would hope that because early intervention will be one of the guiding principles of the FCA, major problems would be averted before FOS had received numerous complaints. A good recent example of effective early intervention appears to have been the prompt exercise of its enhanced section 404 powers by the FSA in February 2011 in respect of certain Halifax bank mortgage contracts.

57. While it is very important that the relevant parties should work as quickly as practicable towards a resolution of any particular matter, in some cases the issue might be complicated and it might take time to reach a satisfactory conclusion. In those cases, complaints to FOS would need to be frozen, and FOS would deal with them subsequently on the basis of the determination made by the regulator or the courts.

58. Separate, but related, points include the increasing presence of claims management companies (CMCs) in financial services complaints, the unscrupulous activities of some CMCs, and questions concerning 'frivolous and vexatious' complaints (which we believe should be defined within the DISP rules, with relevant guidance/criteria). Because (we believe) of resource issues, the regulation of CMCs faces a serious challenge in keeping pace with the growth of these organisations in respect of financial services cases. However, we and other bodies work closely with the Ministry of Justice, which clearly takes its responsibilities very seriously.

11. Do you have any views on the proposals for markets regulation by the FCA, described in paragraphs 2.120 to 2.123 and in Chapters 3 and 4?

59. As noted in our response to *Building a Stronger System*, the BSA is relatively inexperienced in wholesale market matters and, therefore, had few detailed comments. We agree, in principle with the decisions to retain the listing function as part of the FCA and to retain the Part 18 FSMA regime for recognized investment exchanges, but we defer to more experienced commentators in respect of technical details.

12. Do you have any comments on the governance, accountability and transparency arrangements proposed for the FCA, as described in paragraphs 2.124 to 2.132 and in Chapters 3 and 4?

60. The BSA broadly supports the proposals, referred to in paragraphs 2.124 – 2.129, dealing with the governance and accountability of the FCA, including FCA Board arrangements, retention of the practitioner and consumer panels, maintenance of the arrangements for the investigation of complaints, freedom of information provisions and reporting to HM Treasury.

61. We strongly support the decision that the FCA will share with the PRA the common principles of –

- efficiency
- proportionality

- consumer responsibility
- responsibilities for senior management
- openness and disclosure, and
- transparency.

62. As noted in our response to *Building a Stronger System* (and above), we have certain qualifications, which persist following the publication of the White Paper, concerning the following –

- the description of the FCA as a "consumer champion", although we welcome the confirmation that the new body will act as an impartial regulator
- exercise of the new powers concerning financial promotions and early publication of disciplinary action
- 'regulation by speech'
- guidance consultations (see paragraph 48 above).

Firms and consumers are entitled to as much certainty as is practicable and each of these matters could potentially lead to confusion and, potentially, unfair regulatory outcomes.

13. Do you have any comments on the general coordination arrangements for the PRA and FCA described in paragraphs 2.138 to 2.149 and in Chapters 3 and 4?

63. While fully accepting that each new regulator will need to conduct their activities using methods that they regard as effective, the move to 'twin peaks' regulation risks the abandonment of mechanisms that already work well. There is also the risk of separate functions developing that cause unnecessary duplication, complexity or confusion, especially for dual-regulated firms (ie those regulated by the PRA ***and*** the FPC).

62. In practice, the risks could be reduced by the retention of –

- a common gateway for dual-regulated firms in respect of authorisations, approvals, variations, waivers, notifications etc
- the integrated regulated reporting system (GABRIEL)
- a single regulatory handbook – or, if this is not possible, two coordinated handbooks ie containing presentational and operational features that are consistent, so that dual-regulated firms do not need to 're-learn' the Handbook mechanics.

The sharing of back office functions by the PRA and the FCA (eg IT systems), wherever practicable, would also be desirable – these should flow readily from the transitional, ‘shadow’ regulatory structure.

63. The May 2011 paper on the PRA, the June 2011 paper on the FCA and the White Paper are broadly encouraging. We particularly note the confirmation in the White Paper that “*Industry representatives were almost unanimous in their view that there should be some form of ‘single point of contact’ or ‘shared services’ for regulatory processes”* and are encouraged by the Government’s decision to incorporate arrangements for a single gateway into the draft bill.

64. The White Paper acknowledges the point about integrated reporting systems (paragraph 2.134), but states that the Government will leave operational specifics to the regulators, rather than the Bill. The BSA recognises that there has to be a limit to the practical arrangements that may suitably included in legislative provisions. Therefore, it is particularly important that the new regulators coordinate in order to ensure that mechanisms that work well, and could apply equally to a twin peaks system as to a single regulator arrangement, are retained.

65. The PRA paper states that consideration will be given to common standards and rules for risks that are directly relevant to both regulators and the White Paper confirms that the Bank and the FSA will publish a paper on operational coordination. Again, this is helpful. The White Paper states that shared services are not prevented by the legislation (paragraph 2.135) and we hope that, having regard to their statutory obligations regarding coordination and efficiency, the new regulators will go as far as is reasonably practicable in sharing back office arrangements.

14. Do you have any views on the detail of specific regulatory processes involving the PRA and FCA, as described in paragraphs 2.150 to 2.195 and in Chapters 3 and 4?

66. As noted above, we strongly support the proposals regarding a common gateway for the authorisation process a ‘single gateway’ (Clause 8), provisions for coordination on variations etc (Clause 7), primary responsibility for PRA to designate SIFs etc. It appears that no roles will require both PRA and FCA approval (Clause 11).

67. The BSA also welcomes the minor amendments to the building societies’ legislation, flagged in paragraph 2.167. We understand that, although the relevant provisions are not yet in the draft bill, they will be included in due course.

68. A great deal of detail on regulatory functions is set out in Clauses 6-41 and we set out below certain specific observations

69. There is a detail in the consultation requirements for the PRA and FCA in the Bill which has not come out right. Under existing FSMA, FSA must publish what is generally called a "compatibility statement" in accordance with present section 155 (2) (c) explaining why it believes making the rules is compatible with its general duties under section 2. Those duties are not only to act in a way that furthers the FSA's objectives, but- critically - also to have regard to the "principles of good regulation" in section 2 (3).

70. The equivalent requirements on PRA / FCA express the requirement to publish a compatibility statement differently. For the PRA, new section 138K (2)(d) simply calls for " an explanation of the PRA's reasons for believing that making the proposed rules is compatible with section 2B (1) ". New Section 2B (1) refers only to the PRA's single general objective. The duty to have regard to regulatory principles is found later, only in new section 2G. The effect is that the compatibility statement does not cover an explanation of how making the rules has had regard to the regulatory principles.

71. A similar position arises in relation to the FCA under new section 138J (2) (d) and new section 1B (1). So, the scope of the compatibility statement is narrowed and the transparency and accountability of the new regulators' observance of the regulatory principles is undermined from the start. The drafting needs to be amended. We also observe in passing that in the consolidated version of FSMA the references to the FCA's and PRA's objectives in new sections 138 J and K have ended up the wrong way round.)

72. We would welcome clearer information on how the regulators' commitment to coordination (clause 3D) will be assessed in practice. The memorandum of understanding will no doubt be helpful, but how is its effectiveness to be supervised? We also question why clause 3E(2) is permissive ie why, on current plans, the memorandum of understanding between the regulators will not be required to cover a range of important processes. Furthermore, clause 3E(8)(b) provides an exception to the requirements if the relevant aspect is a technical or operational matter not affecting the public. We seek clarification as to why regulated firms, whose interests are very relevant in this context, appear to be excluded from consideration.

15. Do you have any comments on the proposals for the FSCS and FOS set out in paragraphs 2.196 to 2.204 and in Chapters 3 and 4?

73. The BSA welcomes the proposals that the FSCS should be the joint responsibility of the PRA and the FCA and that an independent alternative dispute resolution body should be retained in the shape of FOS. We deal with mass claims' above.

Comments and questions on Impact Assessment : Annex C

74. The BSA acknowledges that regulatory restructuring will entail costs. Those costs should be reasonable and proportionate, especially in view of the fact that the financial services industry has already borne the costs of the FSA's supervisory enhancement programme and it faces certain other high costs (eg regarding the FSCS) and is operating in a market hit by recession.

75. We note that the costs of the potential transfer of partial responsibility for the regulation of consumer credit from the OFT to the FCA is subject to an additional cost benefit exercise. The BSA has already expressed its firmly-held view that, if this transfer is to take place, the consumer credit legislation should be left in place, rather than being repealed and the provisions ported into the regulatory handbook.

76. We would like to see –

- careful planning to ensure that smaller firms (especially dual-regulated ones) are not disproportionately affected by regulatory burdens

- methods of ensuring that the proposed IT spend is cost appropriate and effective

- apart from transitional costs, an overall cap on the first year of the PRA and FCA, no higher that the current FSA budget (and clear controls on levels of future budgets).

77. Clause 5 of the Bill sets out welcome principles including cost effectiveness and proportionality. The retention (broadly) of arrangements for cost benefit analyses under the new regime (paragraph 2.76-6 of the WP) is welcome (including any special aspects regarding mutuals – paragraph 2.164), as is the Government's recognition of the *cumulative* costs of regulation, including EU law.

78. But we have a number of concerns about the impact assessment. Future IT expenditure is a particularly serious concern. Paragraph 41 of the latest impact assessment (page 404 of the latest consultation) revises the upper limit for transitional costs for dual-regulated firms under the preferred option from £50/60million to *£100million*. In addition, the best estimate for total cost is raised from £400million to *£770million*. We are not clear why the latter figure has increased – is it due to potential costs of IT development for the two regulators? We believe that there needs to be greater clarity on this point.

79. While we recognise that these items are estimated, and also welcome the confirmation in paragraph 33 that the FCA's and PRA's combined ongoing running costs "should not be materially different (in real terms) in aggregate from the current FSA budget of about £500 million", there appear to some worrying signs of significantly increasing costs.

80. Recent FSA proposed fees and levies consultations have featured the following –

- Increased expenditure was flagged for *"Development of new regulatory reporting forms including development of new, and/or enhanced, IT systems"* (2009-10 – CP 09/7, paragraph 10.10)

- *"Further investment is also needed to address the increase in Information Services (IS) development work and the growing role of IS solutions in facilitating new initiatives. Funding will also be required for the ongoing development of our IS architecture and Knowledge Information programme, and general demand for IS support on existing projects."* (2010-11 - CP 10/5, paragraph 5.24)

- *"In particular, as a result of significant changes to our role and structure - e.g. European-led regulatory change and the UK regulatory change programme - our work has become increasingly data and IT dependent. During 2011/12, we plan to deliver a large number of 'non-negotiable' policies and business initiatives, requiring further investment in the operational platform".* (2011-12 - CP 11/2, paragraph 2.24)

81. Yet, despite such expenditure by the FSA, *Building a Stronger System* (impact assessment, paragraph 9) stated –

> *"In the short run, however, the transition will involve significant expense to the Bank on premises and IT. . . . The Bank is also clear that in order to contain costs in the long run it would not wish to share in the existing IT systems at the FSA, which have relatively high running costs. So in order to reach a position in which it can both ensure integration and exercise a proper control over future costs, the Bank will need to invest in the transition"*.

This comment is repeated in paragraph 9 of the latest impact assessment.

82. The latest impact assessment went on to state –

- *"The FSA has indicated that much of its regulatory IT estate would be in need of amendment or replacement even in the absence of the changes envisaged by the Government's proposals. New or amended systems for the PRA will therefore be developed as part of 'business as usual', though under the guidance of the PRA Transition Programme Board, a joint Bank/FSA body chaired by Hector Sants"* (paragraph 11).

- *"The FSA legal entity will become the FCA and retain the staff and systems not transferring to the PRA. As with the PRA, there will be significant system development, although this would have been necessary in any event and is not seen as part of the cost of the transition*" (paragraph 13).

83. In summary, we seem to have the following position –

- the FSA has incurred high, year-on-year, expenditure on its IT systems

- despite this, the Bank of England/PRA does not want to share the FSA's systems

- therefore, there will be significant new investment in Bank of England/PRA systems in order to meet the new regulatory duties, and

- the FSA/FCA also plan significant systems enhancements on its separate system.

84. We have a number of observations –

- In the case where the FCA system could be purely an extension of the existing FSA system, the number of additional integrations required across the industry would be equal to the number of organisations requiring dual-regulation (ie require an additional connection to the new PRA systems) which would come at associated cost.

- In the case where the FCA system is a *new* system, and would need to be deployed alongside the existing FSA system for a time, the number of additional integrations required across the industry would be equal to double the number of organisations requiring dual-regulation, (ie require an additional connection to the new FCA and PRA systems) which would come with a *substantially* higher associated cost.

- The risk of regulatory conflict at a conceptual or technical level is doubled when you create two new systems as opposed to one new system, and the financial impact of failed transactions due to conflicts between the FSA, FCA and PRA systems would need to be considered and mitigated against, which would again likely come with an associated cost.

- The value of the existing knowledge, experience and nuances of regulatory understanding already built-in to the FSA system and the support organisation surrounding is should not be under-estimated, and the FCA and PRA should bear this in mind when deciding whether two entirely new systems should be created to replace the FSA system, or whether only one could be implemented alongside a progressive update of the existing FSA system.

- If it is decided that no form of sharing of systems would be appropriate and that two separate systems are essential, then the FCA should not discard the existing FSA system unless it can demonstrate that the new system will be more efficient than the old one plus modifications, and that the increased efficiency of the new system will payback the up-front investment cost within a reasonable period of time.

85. Certain questions consequently arise –

- is the Bank entirely convinced that it needs new, separate systems?

- if so, what measures will be put in place to ensure that their new systems are both fit for purpose and cost effective and mistakes from the past have been learnt from?

- how have we reached a situation where the FSA's IT infrastructure has "relatively high running costs" and is deemed unsuitable for use by the PRA, and who is accountable?

- in view of the fact that the FSA (as well as the PRA) needs considerable further IT investment what measures will be put in place to ensure that the new systems are both fit for purpose and cost effective?

- in view of the risks (such as high costs and, even potentially, failure) involved in two separate large-scale IT projects, has the possibility of developing a single new system for the two regulators been considered?

The Building Societies Association
September 2011

Dear Sirs,

I hope that the consultation period is still open.

Box 2.F (6): I am not sure how competition can improve investments, including pensions, for the retail market and the consumer. Competition has the attraction of forcing down costs but it also forces down quality.

Box 2.G 7: I am delighted to hear that at last the Regulator will be taking a proactive regulatory approach.

Box 2 H: The recurrence of "mass detriment" over the last ten years could have been avoided had the FSA decided to regulate products rather than the advice. Financial advisers knew this, as did consumer groups such as "Which". Indeed, in Which dated July 1998 Page 11 I can quote: "Consumers' Association has been campaiging for the FSA to be given a statutory duty to improve the quality of consumers' financial products. (FSA)....to publish comparative information on charges, flexibility, performance and so on for all financial products....Consumers could use this to check whether the products they were buying were good value....The FSA should also make sure that products meet minimum standards of charges, flexibility and do on- before they're sold to the public. "....Taxpayers money should not be used to subsidise products, such as personal pensions, that are poor value..." Unfortunately, this excellent advice was ignored.

At present Consumer Redress allows the consumer to abdicate all responsibility for investments (and other regulated products) and dumps the responsibility on the shoulders of the adviser who has to review the product or investment second-hand. It is essential that the FCA has the capacity to examine investments and products first-hand directly with the investment and insurance house. To date, the FSA has used the excuse that it does not have the resources to do this, yet it expects advisory firms to find the resources to undertake product and investment reviews.

To achieve a "clear, transparent and fair process" the rights and responsibilities of both parties need to be taken into consideration. Consumers have a responsibility to review their investments, to take steps to understand what they are purchasing and not simply abdicate all decision-making when it comes to buying pensions or insurance. There will always be some people who are too lazy or too greedy to read the small print which is why boiler room scams and pyramid schemes still succeed.

Box 2.M 14: HMRC already struggles with its workload, generally to an unsatisfactory standard, which is acknowledged by all. Until HMRC has resolved a number of existing problems I do not think that it should be asked to take on additional roles until it has managed to a satisfactory standard its current ones.

These are the only comments that I have time to make!

Linda Hulls

Consultation response

September 2011

CII Response to 'A New approach to financial regulation: the blueprint for reform' (HM Treasury White Paper)

Summary

The Chartered Insurance Institute (CII) welcomes the opportunity to respond to the Government's White Paper on regulatory reform. Whilst we generally agree with the development of a 'twin peaks approach', we have a number of specific points relating to the proposals:

Conduct of business regulation

- The CII welcomes the FCA's proposed stance to ***"place particular focus on firms' culture as a potential root cause of poor outcomes".*** It is now important to develop a clear framework for how the FCA identifies appropriate/inappropriate cultures.
- Our proposition, which is supported by previous FSA research, is that those **firms and practitioners** demonstrating professional behaviour through a verified commitment to qualifications, continuing learning and a code of ethics are **less likely to mis-sell products** to consumers as they are more willing and able to provide sound advice. We believe that improved professional conduct fits well with the ambition of the FCA to prevent rather than 'clear up' detriment.
- **In a new era of 'differentiated', risk-based regulation, FCA supervisors must distinguish between those that make a demonstrable commitment to professionalism from those that do not.**

Prudential regulation

- Similar to conduct of business regulation, effective prudential regulation also depends on supervisors making judgements about firms' cultures and behaviours.
- Unfortunately, the PRA's proposed approach to take account of firms' cultures does not appear substantially different to the current 'risk assessment framework'. Senior FSA, HM Treasury and Bank officials are adamant that supervisors will have "no right culture in mind" when assessing the level of risk posed by firms. The implication is that they will only seek to address cultural deficiencies after detriment has occurred.
- **In our view, this stance is worrying**. To demonstrate this, we reflect on the latest research into the attitudes and opinions of practising risk managers which suggests that those working within the field of risk management place far greater emphasis on micro-level human and social factors as **determinants** of financial crises than those working in regulation.

Separate insurance objective

- The CII welcomes the approach to regulate insurance differently to banking and the new objective to protect the policyholder from an 'Equitable Life-type' event.
- However, it is concerning that, as a result of the new objective, insurance is likely to face proportionally more intense supervision than banks. In the context of the recent banking crisis and the continuing concerns resulting from banks' exposures to European sovereign debt, this outcome would not seem like a 'risk-based approach'. **A separate objective should still be proportionate.**

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About the CII

The Chartered Insurance Institute is the world's leading professional body for insurance and financial services with over 100,000 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.

Question 1. Views on the proposals for the FPC

Governance

The Treasury, Bank of England and FSA have all tried to dispel industry concerns that regulating insurance will be a secondary concern as the new architecture takes hold. The separate PRA insurance document, new insurance objective, and the implication that insurance firms may have to be regulated more intensely than similar sized banks, all reflect this. Given these efforts then, it is odd that the Financial Policy Committee, with its powerful remit to spot emerging crises and initiate mitigating action, has minimal insurance expertise. There remains a risk that issues that arise in the insurance sector are missed or misunderstood if the Committee members do not have sufficient background experience.

Financial Stability and Growth

Macro-prudential tools can be broadly grouped into two categories. The first is to "address the fundamental vulnerabilities in the system, while the second is to increase the resilience of the financial system to cyclical developments"[2]. Whichever macro-prudential tools are used however, there will be consequences on the level of supply and price of credit available to the real economy.

In its submission to Government, the Treasury Select Committee neatly explains:

> *"...by increasing capital adequacy requirements, banks will need either to raise extra capital or to reduce their risk-weighted assets, from which the consequences will be a higher lending rate and reduced availability of lending, including mortgages, from UK banks. Introducing a loan-to-value cap and leverage limits will have similar effects - as long as funds do not flow from non-bank sources, or from overseas."*[3]

The deployment of macro-prudential tools may therefore have adverse implications for individual consumers and by implication, economic growth. It is crucial that before deploying such tools, the FPC is confident that the financial stability benefits outweigh the likely economic costs. From this analysis a key question arises: how much financial stability risk will the FPC will be prepared to take before committing to a course of action that might threaten growth?

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

[2] Treasury Select Committee (January 2011) ***Financial Regulation: a preliminary consideration of the Government's proposals***
http://www.publications.Parliament.uk/pa/cm201011/cmselect/cmtreasy/430/43006.htm#a12

[3] Ibid

In our view, this is not just a question for members of the FPC but also for society as a whole. Just as Hector Sants has said it is up for society to decide how far the FCA should go in trading costs, innovation and choice for greater consumer protection[4], so society must play a key role in determining how far it is prepared to go in trading economic activity for financial stability. It is therefore essential that there are proper accountability mechanisms involving Parliament and the Treasury. Whilst we welcome the statutory obligation to reduce the impact of FPC activities on economic growth, and the requirement to publish biannual financial stability reports before Parliament, we still think that the proposals are relatively light in this regard. In our view, before Parliament can endorse the proposals for the FPC, it must have details about how possible macroprudential tools will work in practice and what trade-offs these will involve.

Question 4. Objectives and scope of the PRA

Culture and prudential regulation

The PRA approach document gave a clear indication that understanding firms' cultures and behaviours would be an important element of the new supervisory process. The document specifically stated that the prudential regulator will 'take account of firm's cultures', and in his speech at the PRA Insurance Conference, Hector Sants spoke about the limitations of risk mitigation based on modelling alone. The remedy said Sants, was more experienced supervisors, better analysis of firms' business models (especially capital and funding models), better analysis of firms' governance model, and a **"clear understanding of the firm's culture and the implications of that culture on its risk profile"**[5].

This provision for culture in the prudential supervisory process is welcome. However, on paper at least, it does not appear substantially different to the current 'risk assessment framework' which also considers **management, governance and culture**. Indeed from a close reading of the PRA approach document, it appears that supervisors will only make judgements about a firm's culture after detriment is likely to have taken place:

> *"...**supervisors will not have any specific 'right culture' in mind when making assessments**, but they will focus on whether a firm is achieving the right regulatory outcomes. Where those are not being achieved, however, the PRA will expect the governing body to reconsider culture and, where necessary, to make changes to improve regulatory outcomes."*[6]

In short, the regulator will seek to understand the cultures of firms but will only act once failure to achieve other regulatory outcomes has occurred. In our view, this would still demonstrate a rather reactive approach to supervision and not a step-change in the nature of prudential regulation as proposed by the Government and FSA.

Micro-level human and social factors (such as risk cultures, management attitudes and skills) are important if often neglected causes of financial crises. Recent research undertaken by risk management expert and Associate Professor Simon Ashby, reveals that many practicing risk managers place significant emphasis on these human factors as key reasons for the recent financial crisis[7].

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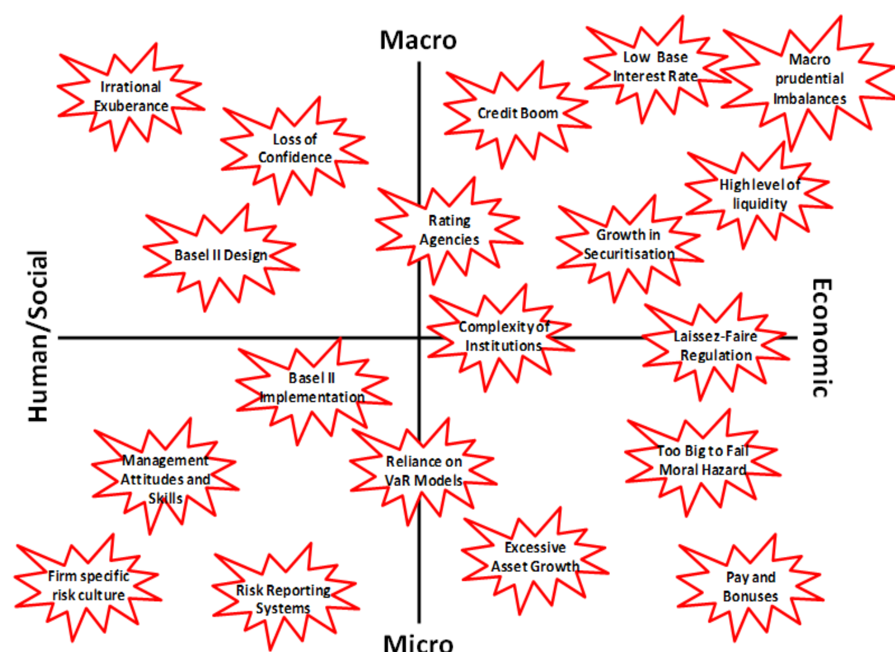
[4] See comments by Hector Sants (June 2011) ***Speech by Hector Sants, Chief Executive, FSA at the Financial Conduct Authority Conference*** http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2011/0628_hs.shtml

[5] Hector Sants (June 2011), ***Speech by Hector Sants, Chief Executive, FSA at the PRA Insurance Conference,*** http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2011/0620_hs.shtml

[6] FSA and Bank of England (June 2011), ***The Bank of England, Prudential Regulatory Authority: Our approach to insurance supervision*** p.12 http://www.fsa.gov.uk/pubs/other/pra_insurance.pdf

[7] Simon Ashby (August 2011), ***Back to Basics: Rethinking Risk Management and Regulation in a post-crisis world***, CII Thinkpiece no. 61. This thinkpiece follows on from Ashby, S. (2010) ***The 2007-2009 Financial Crisis: Learning the Risk Management Lessons***, Financial Services Research Forum, Nottingham

Figure 2. Some commonly cited causes of the financial crisis



Source: Ashby (2011) undertook in depth interviews with twenty risk management professionals from across financial services.

During his interviews, Ashby found that none of the risk managers supported the view that risk-based capital regulations underpinning initiatives such as solvency II or Basel II, "will lead to improvements in risk management. Indeed for some, the financial sector's increasing reliance on models was seen as a key cause of the crisis." Ashby therefore argues that discussions about the "structure of financial institutions cannot be divorced from those about the behaviours and competencies" of management.

> *"Even in high risk environments, risk can be controlled by effective management (**who are competent and professional,** and are prepared to communicate with each other and work together) operating within an appropriate risk culture that promotes awareness, values management judgement as much as models and links risk and strategic management."*

From this analysis it is clear that PRA supervisors must not just seek to understand a firm's culture and how this impacts upon levels of risk, but also take action when they deem a firm's culture to be 'inappropriate' even if firms are achieving other regulatory outcomes. In short, **it must be the case that supervisors' judgements on culture play a key role in determining where firms are placed within the new 'proactive intervention framework'.**

The separate insurance objective

The CII welcomes the approach to regulate insurance differently to banking and the new objective to protect the policyholder from an 'Equitable Life' type event. It is absolutely right that the regulator should be looking to sustain a financial world where an insurer has a "high probability of meeting claims from and material obligations to policyholders as they fall due"[8]. However, it is concerning that, as a result of the new objective, insurance is likely to face proportionally more intense supervision than banks[9]. In the context of the recent banking crisis and the continuing concerns resulting from banks' exposures to European sovereign debt, this outcome would not seem like a 'risk-based approach'. The Treasury, together with the Bank of England and FSA, must make more of an effort to

[8] FSA and Bank of England (June 2011)
[9] See comments made by Hector Sants (June 2011), ***Speech by Hector Sants, Chief Executive, FSA at the PRA Insurance Conference,*** http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2011/0620_hs.shtml

ensure that prudential regulation is proportionate to risk, and further details are required about how the new insurance objective will work in practice.

Question 6. The FCA's competition remit

The CII supports the inclusion of a **competition duty** rather than a specific competition objective. Ultimately, the FCA's primary focus should be on delivering better consumer protection and this is not necessarily best served through the promotion of competition.

In certain financial services sectors, such as motor insurance, there are already a significant number of firms selling numerous products to compete fiercely for market share. However, this does not guarantee customers get value for money or protection from mis-selling. In our view, the key to securing the public interest is to ensure that consumers are able to understand what products best match their needs and risk appetites, and this requires **clear and transparent products** as well as **appropriate advice** from practitioners. Whilst this is related to the notion of 'perfect competition'[10], the market for financial services suffers more than most from asymmetries of information, complexity, behavioural biases and lengthy terms, presenting significant challenges to a properly functioning demand side. This means that sometimes regulatory interventions must go beyond purely enhancing competition in order to protect consumers, particularly if targeted interventions will prevent the sorts of bulk mis-selling which has blighted parts of financial services in the past.

The crucial challenge for regulators will be to spot the next PPI-style problem at an early stage. To be successful, the FCA will require new skills and a different organisational culture.

Question 7. Views on the FCA's proactive regulatory approach

The CII welcomes the FCA's proposed stance to ***"place particular focus on firms' culture as a potential root cause of poor outcomes"***[11]. It must be the case that when assessing the probability of consumer detriment, the regulator takes account of the behaviours and cultures of firms and their employees, as much as the more traditional structural and market wide factors. Only then will the regulator be able to attain a ***"deeper understanding"*** *of the* ***"commercial and behavioural drivers*** *and the multiple causes of poor outcomes for consumers"*. The challenge now then, is to develop a clear framework for how the FCA can identify appropriate/inappropriate cultures and behaviours.

Poor cultures, mis-selling and their implications

Poor cultures and behaviours have been a key cause of recent mis-selling scandals. In turn, these scandals have helped to reduce consumer trust in financial services. The result is that the general public are reluctant to engage with financial services even when it is in their best interests. We must reverse this cycle if public trust is to be regained.

Consumer detriment caused by mis-selling scandals

Consumer detriment related to the selling of pensions and endowments in the 1990s and payment protection insurance over the last decade have one thing in common – intermediaries failed to act ethically during the distribution process resulting in the selling of financial products that were unsuitable for the end consumer. To act ethically it is not merely sufficient to have good intentions in terms of putting the consumer first. Those advising

[10] Perfect competition assumes prices and quality of products are known by all consumers. In this context, greater transparency of products should lead to improved consumer knowledge.
[11] FSA (June 2011), ***Financial Conduct Authority: Approach to Regulation*** http://www.fsa.gov.uk/pubs/events/fca_approach.pdf

customers must also be competent enough to understand the risks associated with various financial products and their own limitations in advising on such products[12]. It follows that mis-selling is often both a function of deliberately selling an unsuitable product for financial gain and/or poor levels of competence and understanding about the risks of financial products and the related risk appetite of customers. The FSA identified both issues as key causes of consumer detriment as part of the Retail Distribution Review.

Decreased trust in financial services

Poor cultures do not just cause consumer detriment through mis-selling but also, as a result of reduced consumer trust, are an important contributing factor to the UK's large savings and protection gap.

Trust of financial services in general is relatively low. The decline in levels of trust was well documented in a survey undertaken by the CII in late 2010 which found that one in five respondents will never trust financial services again and 72% of people have not very much trust or no trust at all in financial advisers and life insurance providers[13].

Low levels of trust is a key cause of **inertia** whereby consumers fail to act even when it is in their best interests. In this context it is worth referring to a recent report by the Social Market Foundation which neatly explains why distrust of financial services is such an important cause of inertia:

> *"A pervasive sense of distrust among consumers means they are likely to write financial service providers off as 'all the same', without even checking what is on offer on the market. Furthermore, behavioural economics suggests that consumers become disengaged in the face of market complexity: they are therefore less likely to check the market if they cannot easily understand or compare products on it."*[14]

Inertia has therefore helped contribute to the significant savings and protection gap that was quantified in the Treasury's Simple Products Consultation Paper earlier this year. It is estimated that around **a quarter of UK households have no savings at all** and that the protection gap – the difference between "the amount of cover people hold and the level they should ideally have in place to cover their protection needs" is close to **£2.5bn**[15].

Delivering an appropriate culture through professionalism

Raising the professionalism of practitioners is one way to tackle the problem of mis-selling and the related problems of consumer distrust and inertia. By professionalism we refer to three elements of professional standards:

1. **Qualifications:** Improvements in qualifications to raise the level of knowledge and understanding of practitioners.
2. **Continuing professional development (CPD):** By undertaking continuous learning, practitioners are able to keep their knowledge and understanding up to date.
3. **Ethics:** A commitment to act in the interests of consumers is crucial to ensuring honest selling practises.

Each of these 'pillars of professionalism'[16], are directly associated with the likelihood of consumer detriment. If practitioners adhere to the highest standards of qualifications, CPD and ethics, it is less likely that they will either deliberately mis-sell for personal financial gain at the expense of the consumer, or accidently mis-sell a product due to a lack of understanding about product risk. Distributors will want to deliver a service that matches the

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[12] K. Redhead, "***Behavioral Perspectives on Client Mistrust of Financial Services,***" *Journal of Financial Service Professionals* (Working paper)
[13] CII (February 2010) ***What we talk about when we talk about trust,*** p.12 http://www.cii.co.uk/downloaddata/Trust_CII_2010.pdf
[14] Social Market Foundation (July 2011) ***A Confidence Crisis? Restoring Trust in Financial Services*** edited by John Springford, p.13
[15] HM Treasury (December 2010) ***Simple Financial Product Consultation Paper,*** p.9 http://www.hm-treasury.gov.uk/d/simple_financial_products_consultation.pdf
[16] 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

customer's risk appetite and they will have the skills to do it. They are therefore more likely to sell products that are appropriately tailored to the individual.

The FSA and the Treasury have acknowledged the importance of each of these characteristics of professionalism 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,[17] found that advice from practitioners meeting the highest professional standards was deemed suitable in **71%** of cases whereas advisers with the current mandatory qualification delivered suitable advice in just **11% of cases.**[18]

However, professionalism in insurance and financial advice does not just refer to the characteristics of individual advisers, brokers or underwriters. Firms as a whole can also make a commitment to professionalism of which characteristics can include:

- **Corporate experience and expertise:** management that has the necessary experience and expertise to ensure that the business model is sustainable implemented effectively;
- **Corporate systems and controls:** including corporate governance that exerts appropriate levels of control over the running of the business including risk management, maintaining adequate capital, record keeping, training and competency programmes and developing a culture that encourages the fair treatment of customers; and
- **Employee professional support:** encouragement of professional standards for employees through supporting technical training and development and encouraging appropriate behaviour.[19]

In summary, regulators and their supervisors should not just consider whether individual practitioners have made commitments to professionalism but also whether firms have made an organisation-wide commitment to the highest professional standards. Those that do commit are likely to pose less risk of consumer detriment than those that do not.

Evidencing professionalism through verifiable standards

As the leading professional body for insurance and financial services the CII is committed to protecting the public interest by guiding practitioners in the sector towards higher ethical and technical standards. As part of this process we award Chartered status to those individuals demonstrating the highest levels of qualifications, CPD and ethics. They must maintain these standards to continue to hold the title Chartered. **We also award the Chartered title to firms demonstrating best practice.**

Chartered firms

To become Chartered, firms must ensure staff members acquire and retain the necessary knowledge and skills to deliver the highest quality services and advice. They must also work in an ethical manner that places clients' interests at the heart of the services they provide. Chartered status, granted by the Privy Council, gives insurers and financial planners parity with other professional firms and distinguishes the Chartered title holders from competitors.

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[17] 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

18 FSA (June 2010) Consultation Paper 10/14: ***Delivering the RDR*** http://www.fsa.gov.uk/pages/Library/Policy/CP/2010/10_14.shtml

[19] Each of these characteristics were identified in a CII report (2007) entitled ***Professionalism and Reputation***
http://www.cii.co.uk/downloaddata/pfs_rdr_professionalismandreputation.pdf

For example, **Chartered broking firms** must meet a number of key requirements including:

- A minimum of one of the board's members must personally hold the CII Chartered Insurance Broker title.
- One of the firm's board or highest management team (who, as an individual, holds the Chartered Insurance Broker title), must take on the role of Responsible Member.
- The entire board or highest management team together with a minimum of **90% of customer facing staff** must be members of the CII.
- Access to a Chartered Insurance Broker must be available to customers.
- Firms must have a professional development programme in place.
- Firms must have core values that align with the CII's Code of Ethics.

A corporate Chartered title is therefore a commitment to an overall standard of excellence and professionalism. A firm which holds each of these elements is one whose strategy is focused on delivering quality products and services to the consumer – epitomised through the achievement of rigorous learning and development for employees and a proven commitment to ethical practice.

We suggest that FCA supervisors should take 'Chartered' into account when assessing whether or not firm's governing bodies have "set, embed[ded] and maintained a firm-wide culture that supports an appropriate degree of protection for customers". At the very least, the fact that firms have spent time, money and intellectual effort to attain the title Chartered shows that they are not just driven by a concern for profit at any cost. Indeed for these firms, reputation for quality is paramount.

Professionalism is of course only one part of the mix of indicators that the FCA will have to look at when assessing the level of risk posed by firms on consumers. But by failing to understand a firm's commitment to best practice in this way, they will miss an important part of the picture.

While the concept is still a relatively new one, it is developing support rapidly as it offers an interesting option to develop professional standards at a firm rather than individual level. There are currently **over 400** Chartered firms.

Aldermanbury Declaration

In co-operation 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 is a voluntary industry-led initiative that 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.

By the first anniversary of the Declaration, 200 firms including all major insurers had 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.

Firms that have signed up to the Aldermanbury Declaration have also made a long-term commitment to professionalism suggesting that their management are also determined to improve the outcomes for consumers. The fact they have made such a commitment should be noted by supervisors as part of their assessment firms' cultures.

The FSA has, through the Retail Distribution Review, already explicitly recognised the importance of raising professional standards for improving consumer outcomes. We believe the FCA should welcome and acknowledge these latest industry-led initiatives to promote the same end.

Both the Chartered firms and Aldermanbury Declaration initiatives, reflect a growing movement towards higher professional standards across general insurance and financial planning. If, as we believe, increased professional standards decrease 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.

Professionalism and consumer trust

As well as reducing the chances of mis-selling, there is also evidence to suggest that professionalism helps tackle the associated problem of consumer trust and inertia.

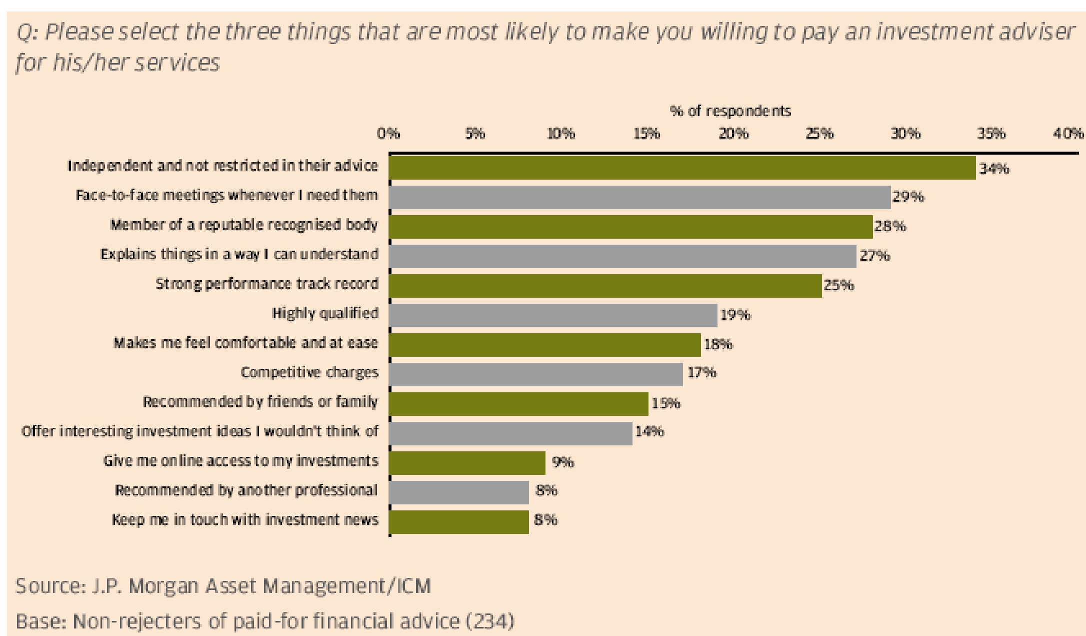
In 2009, on behalf of the CII, YouGov surveyed over 2,000 members of the public in an effort to understand consumer views about Chartered firms and individuals. This in-depth survey found that an important factor in determining whether or not people trusted a financial services firm or practitioner was whether they held the title 'Chartered'[20]. 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.
- Consumers have more confidence in the quality of organisations that use the term Chartered than those that are not Chartered.

There has also been research published on the links between professional body membership and consumer trust. A recent survey conducted by JP Morgan on financial advice found that a key driver determining whether a consumer is willing to pay for advice is membership of a professional body.[21]

[20] CII (Polling by YouGov) (2009), ***Consumer Views of Chartered Status***: http://www.cii.co.uk/downloaddata/Consumer_views_of_Chartered_status.pdf
[21] J.P. Asset Managment (May 2011) ***Adviser charging: putting a price no financial advice***
http://www.jpmorganassetmanagement.co.uk/Adviser/_documents/JPMAM_Adviser_Charging_Report.pdf

Figure 1. Drivers that make consumers willing to pay for an adviser



Source: J.P. Morgan Asset Management

A paper written for the FSA by Jackie Wells and Mary Gostelow explains why membership of a professional body may inspire consumer confidence:

> *"Professional bodies play an important role as a proxy that enables consumers to place their trust in a professional. Knowing that a professional is regulated, meets certain standards of knowledge and is subject to a code of ethics facilitates trust even when the individual professional themselves is not known."* [22]

The above research is noteworthy, particularly in light of the Government's priority to close the savings and protection gap.[23] High levels of professionalism epitomised by the title Chartered and membership of a professional body, appear to act as a break against the current wave of mistrust felt by the general public towards financial services. It follows that an increase in the number of Chartered firms and practitioners may, over time, lead to an improvement in the levels of trust and engagement with financial products and services. **By ensuring that supervisors take account of developments like 'Chartered' and the Aldermanbury Declaration in their risk assessments of firms, the regulator can provide an incentive for other firms to adopt best practice helping to improve standards across the industry.**

Other general points: the FCA's new powers of intervention

The CII recognises the need to reform conduct of business regulation given the occurrence of significant consumer detriment under the FSA. Part of rebuilding confidence in financial services relies upon consumers being able to trust financial services regulation. However, as implied during Hector Sants speech at the FCA conference[24], the regulator's new powers for intervention could, if left unchecked, significantly increase costs for consumers whilst reducing innovation and choice.

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[22] Wells and Gostelow (Nov 2009, updated 18 March 2011) ***Professional Standards and Consumer Trust,*** Prepared for the FSA: http://www.fsa.gov.uk/pubs/other/psct.pdf

[23] See for example the recent discussion paper from the Treasury on **Simple Financial Products:** http://www.hm-treasury.gov.uk/consult_simple_financial_products.htm

[24] Hector Sants (June 2011) ***Speech by Hector Sants, Chief Executive, FSA at the Financial Conduct Authority Conference*** http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2011/0628_hs.shtml

New powers for transparency, disclosure and early publication could also, if used hastily, risk unnecessarily damaging consumer confidence in financial services by wrongly punishing firms that have been behaving correctly. Whilst we therefore support the approach for more regulatory intervention at both the design and distribution stages of the product lifecycle, more consultation is needed in order to strike the most appropriate balance between protection, trust and consumer choice. The public interest must remain paramount but it can be served by appropriate and proportionate interventions rather than merely a general increase in regulation.

In this regard we welcome new section 138P of the draft Bill which requires the FCA to consult on and publish a statement of policy governing the circumstances in which it may make temporary product intervention rules. Similar consultation is needed over the FCA’s power to disclose warning notices in relation to proposed disciplinary action.

Question 8. Allowing nominated parties to refer issues to the FCA

The FCA should make explicit use of other sources of information in order to proactively identify possible causes of consumer detriment. In this regard we support the idea that the Financial Ombudsman Service can refer specific issues to the FCA as a ‘nominated party’. In her evidence to the Treasury Select Committee, Chief Ombudsman Natalie Ceeney highlighted how FOS complaints often arose as a result of “systemic issues” and how it was important to streamline the referral process to reduce detriment[25]. A key test then of this relatively ‘green’ proposal is whether it is likely to improve transparency and communication between the Ombudsman and the regulator, shortening the time it takes to act once an issue has been identified. It is important though, that in referring issues and resolving cases, the FOS remains completely independent of the regulator. The CII will be interested to see how proposals on this front develop.

Question 13. General coordination arrangements for the PRA and FCA

General Coordination

The new regulatory architecture will be more operationally complex than the FSA’s. It is therefore likely to face greater challenges in terms of coordinating its response to specific regulatory issues, its day to day supervision and its policy making. In this respect we welcome the proposed statutory duty on the PRA and FCA to coordinate their activities, the obligation to prepare a memorandum of understanding and the commitment to having cross membership of boards.

However, whilst these additions may help to ensure a minimum level of coordination, ultimately effective collaborative working will be determined by the **attitudes and behaviours** of line supervisors and policy teams. Therefore, whilst the nature of financial regulation is often fairly secretive due to the sensitive nature of the commercial information being handled by supervisors, management must, where possible, promote the benefits of close working relationships with other teams, other regulatory bodies and outside experts. In this context, we hope that the Bank of England and FSA paper to be published later this year on operational coordination will **provide details of how a culture of cooperation can be instilled**.

International Coordination

As the current Eurozone crisis demonstrates, the UK’s prosperity is intrinsically linked to the fate of other nations. If Spain was to default on its debt repayments, UK banks would face estimated write-downs of up to £75bn[26] making

[25] Natalie Ceeney’s oral evidence to the Treasury Select Committee Inquiry (14 October 2010)
[26] Jill Treanor (April 2010), ***Debt crisis: UK banks sitting on £100bn exposure to Greece, Spain and Portugal,*** Guardian
http://www.guardian.co.uk/business/2010/apr/28/debt-turmoil-bank-crisis-fears

further Government-led recapitalisations necessary. This example illustrates the importance of strong UK represention at the international level.

To ensure a consistent strategic view, the draft Financial Services Bill proposes an MoU between the various regulatory bodies. We believe that this may not be sufficient to ensure that the UK speaks with a single authoritative voice in international debate. We would therefore reiterate the CBI's call for the establishment of "an executive level international coordination committee, directly accountable to boards of 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".[27]

Conclusion

In summary, whilst we agree, in principle, with the general thrust of the 'twin peaks' approach to regulation as set out by the Treasury, there is still significant work to be done in order to ensure an effective regulatory system. In particular, we hope that in coming to judgements about the prudential and conduct of business risks posed by firms, supervisors in their new bodies take account of the cultures and behaviours driving individual as well as firms' decision making. Without this provision for culture, the regulators will fail in their job of delivering a proactive regulatory regime that is able to prevent financial crises and mis-selling scandals from occurring in the first place, instead of being preoccupied with clearing up the mess afterwards.

Date: 8 September 2011

Contact: Ben Franklin, CII policy and research coordinator, ben.franklin@cii.co.uk

[27] CBI (April 2011), ***CBI response to A New Approach to Financial Regulation: Building a Stronger System*** http://www.cbi.org.uk/pdf/20110401_cbi-response-building-a-stronger-system.pdf

Evidence

A new approach to financial regulation: the blueprint for reform

Response from Citizens Advice to HM Treasury

September 2011

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Introduction

Citizens Advice welcomes this opportunity to respond to HM Treasury's White Paper and consultation *A new approach to financial regulation: the blueprint for reform.*

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.
- To improve the policies and practices that affect people's lives.

The Citizens Advice service is a network of 394 independent advice centres that provide free, impartial advice from more than 3,500 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.

Our general comments on the draft Financial Services Bill

Our comments in response to the consultation are mainly focused on the FCA and the broader consumer protection aspects of the Bill. Citizens Advice believes that an effective conduct regulator is vital to ensure consumer confidence in the financial services market. The recent history of the financial services sector has been marked by a succession of problems causing widespread consumer detriment. In some cases, such as payment protection insurance, the scale of detriment arising from mis-selling and poor product design has become scandalous.

Citizens Advice agrees with the analysis by the Government and the FSA that these problems highlight regulatory failures and weaknesses in the current FSMA regime. Therefore we warmly welcome the measures set out in this Bill to re-focus conduct regulation and equip the new conduct regulator with the right tools to stop more widespread consumer problems in the future.

In particular we welcome the measures on product intervention, greater regulatory transparency, misleading financial promotions and the requirement for firms to satisfy the regulator that a business model is suitable. We believe that this is a well thought out package that learns form past experience, builds on recent necessary reforms (such as the new Section 404 collective redress provisions) and supports the FSA's unfolding new approach to conduct regulation.

Citizens Advice also strongly supports the proposals set out in this consultation to establish a 'super-complaint' like process for the FCA. The lack of a clear duty for the regulator to investigate evidence of consumer problems and then act, where necessary, to resolve them has been one of the central weaknesses of the current FSMA regime. Placing the FCA under such a duty would be a very significant improvement.

However our response also raises questions about areas of the Bill where we feel the proposed legislation does not appear to meet the stated goal of putting consumer outcomes at the centre. In summary, these include:

- The FCA's consumer objective is not sufficiently focused on consumer outcomes, and the needs of hard to reach consumers and people with little consumer power in particular.
- The FCA's efficiency and choice objective looks under defined and the regulator's mandate to ensure marginal consumers are not underserved by the market looks too weak.
- The Bill is not clear how any tensions arising between the objectives and powers of the FPC and PRA on one hand and the needs of consumers on the other will be resolved.

Our responses to the consultation questions are set out below.

Response to specific questions

1 Do you have any specific views on the proposals for the FPC as described in paragraphs 2.6 to 2.24 and in Chapters 3 and 4?

As a consumer advice and advocacy organisation Citizens Advice has no particular knowledge, experience or expertise of macro-prudential regulation policy. However we do have some recent experience of dealing with the consequences of macro-prudential regulation policy as this has been experienced by everyday people.

Analysis underpinning this White Paper and elsewhere highlights how failures in prudential regulation policy contributed significantly to the financial crisis that started in 2007. As the crisis spread from the banking sector to the rest of the economy, the sharp contraction in output in 2008 and 2009 filled CAB waiting rooms with people seeking advice about unemployment, redundancy, mortgage arrears and other debt problems.

The point here is to highlight the potential real world consequences that prudential regulation can have on consumers. This is not just a question of avoiding another regulatory failure, but also of ensuring that future action by prudential regulators to

maintain financial stability takes proper account of the possible consequences for different groups of consumers.

Here our main concern would be in respect of markets for mortgage and consumer credit. Clause 3 of the Bill introduces objectives of the FPC that include taking action to remove or reduce systematic risks, which are in turn defined as including 'unsustainable levels of leverage, debt or credit growth'.

Citizens Advice has argued for much of the last decade for more effective conduct regulation to prevent excessive lending to consumers from fuelling unmanageable debt. This is and remains an extremely important policy concern and we look forward to the policy statement from the FSA outlining how they will take forward measures to make the MCOB responsible lending rules more effective. Here we would raise the point made in the turner Review that weak credit standards in the US mortgage market provided the initial stimulus that 'triggered a self reinforcing set of effects' that led to the global financial crisis[1].

However these conduct regulation arguments are focused on ensuring that credit commitments are suitable and affordable for individual consumers before they enter into a credit agreement. In contrast, the FPC's power to take action to reduce or freeze levels of lending or outstanding debt on an economy wide basis would likely have an impact on people with existing mortgage and credit commitments. Indeed as the new Section 9C (4) of the Bank Of England Act 1998 requires the FPC to avoid any significant adverse effect on the capacity of the financial sector to contribute to growth, the suggestion is that the burden of any such action would fall particularly on consumers. In other words, consumers would experience this as a sort of regulatory credit crunch.

As we saw in 2007, lenders responded to a blanket change in market conditions by restricting credit availability or increasing the price of credit, particularly to consumers perceived as more risky or more marginal to the market. The experience of some CAB clients shows how this had lasting detrimental consequences for those consumers who were not able to adjust; often lower income consumers, those with higher objective risk profiles and those carrying a high existing credit burden. For instance:

Citizens Advice saw an acceleration in the number of people seeking advice about mortgage arrears in Autumn 2007. The credit crunch pushed up some lenders' standard variable rates, closed off availability to re-mortgage options for borrowers at the end of fixed term deals and left people unable to sell up when faced with unaffordable mortgage payments. This problem was later mitigated by falling interest rates, but some homeowners were exposed to immediate financial difficulties even before the onset of the recession.

> **A CAB in Cheshire** saw a 25 year old woman who had bought a house with her partner. They had a three year mortgage on a fixed rate deal with payments of £750 month. When this ended the monthly repayments went up to £1,600. They tried to remortgage with other lenders, but had no success. They fell into arrears with the mortgage. They said that there were lots of other houses for sale, some had been

[1] The Turner Review: A regulatory response to the global banking crisis. (2009) Financial Services Authority

on the market for months and so they felt it would be impossible for them to sell at present.

A CAB in Buckinghamshire saw a woman who was a single mother with a 10 year old child. She was self-employed and her business was suffering from the credit crunch. Her mortgage payments also increased from £1,600 per month to £2,400 per month while base rates had decreased and other mortgage companies had reduced their payments. She could not afford this and fell into arrears. She received a claim for possession from the court and was very concerned about being evicted.

Citizens Advice also saw people who had unsecured credit lines suddenly re-priced or withdrawn by lenders. Concerns about credit card re-pricing provoked specific action by government, reaching an agreement with card providers to give consumers the option to pay down their balance at the original interest rate. The problems faced by consumers facing the sudden withdrawal of credit facilities (overdrafts in particular) were not addressed in such a prominent way, although in some cases this resulted in severe hardship.

A CAB in London saw a woman who had an overdraft facility for £850 per month which she used to pay her mortgage and bills prior to her salary clearing the overdraft at the end of each month. Without warning her bank wrote to her saying they were withdrawing the overdraft facility. She visited the branch and discussed the matter but was told that there was nothing that could be done to change the decision. The woman suffered financial difficulty and distress.

A CAB in Wales saw a woman who had some debts because of a recent divorce but was starting a new permanent job earning £23,000 per year. As she was to be paid monthly in arrears she attempted to get temporary credit for a month to pay rent, travel costs, and food etc. Despite having a perfect credit history before this time she was refused any extension to credit . Her bank cited the credit crunch as the reason for the refusal. The woman had no money for rent, food and essential travel to work for the month.The client stated that she was highly distressed as she thought she would lose the job if she could not travel.

A CAB in Sussex saw a woman who was a lone parent with two children aged five and three. She lived in private rented accommodation receiving housing benefit, council tax benefit, income support, child tax credit and child benefit. She had a current account with an agreed overdraft facility that her benefits were paid into and had arranged payments to her creditors via standing orders and direct debits. She received a letter from her bank stating they would be withdrawing her overdraft facility within two weeks from the date of the letter. When she called the bank to discuss this she was told that as she had confirmed receipt of the letter the account would be closed immediately. This caused her difficulties as her benefits had just been paid in and were appropriated by the bank. She also had no time to rearrange how to pay her creditors.

Citizens Advice has also seen a growing number of problems experienced by consumers seeking high cost credit at the margins of the market. Our recent report on credit brokers, *Cashing in* and the accompanying super-complaint to the Office of Fair Trading highlighted

how the recession, credit crunch and growth of internet based credit services have combined to expose growing numbers of financially vulnerable consumers to unfair business practices.

As a result we believe that the FPC should be required to give active and explicit consideration of how to mitigate the possible consequences for consumers of any direction or recommendation to further the financial stability objective that would change conditions in mortgage or consumer credit markets.

New Section 9E of the Bank of England Act 1998 requires the FPC to exercise its functions in a way that, as far as possible, does not prejudice the FCA from advancing any of its operational objectives. This would include the *efficiency and choice* objective. But while HMT has stated (at paragraph 4.31 of *building a stronger system*) that this objective gives the FCA a mandate to address financial exclusion, the Bill does not frame the efficiency and choice objective with sufficient strength or clarity to provide any real counterweight to the powers given to the FPC.

We believe that such a counterweight is important both because of the possible consequences of a 'regulatory credit crunch' outlined above and because the FPC will be operating independently of government and hence not directly accountable to the public.

New Section 9D requires HMT to make recommendations to the FPC about matters to which it should have regard in exercising its functions. We would urge the Government to ensure these recommendations include reference to the following points:

- The need to minimise the degree of social exclusion and hardship that consumers might experience as a result of any intervention aimed at levels of credit and debt.
- The need to give consumers sufficient time to adjust to changed market conditions.
- The need to co-ordinate with the FCA to ensure that conduct rules are in place, both to prevent excessive and unsustainable lending to individuals in the first place and to prevent lenders from causing unnecessary hardship to consumers by sudden and unfair re-pricing or withdrawal of credit facilities.

2 Do you have any specific views on the proposals for the Bank of England's regulation of RCHs, settlement and payment systems as described in paragraphs 2.32 to 2.40 and in Chapters 3 and 4?

Citizens Advice has no specific views on these proposals.

3 Do you have any comments on the proposed crisis management arrangements; and the proposals for minor and technical changes to the Special Resolution Regime as described in paragraphs 2.41 to 2.44 and in Chapters 3 and 4?

Citizens Advice has no comments in respect of the crisis management arrangements or the changes to the Special Resolution Regime.

4 Do you have any comments on the objectives and scope of the PRA, as described in paragraphs 2.46 to 2.61 and in Chapters 3 and 4?

Our responses to question 1 and 13 raise a general concern to ensure that regulatory action to meet prudential objectives takes sufficient account of the need to avoid undue harm to consumers that are not able to adjust to any changed market conditions resulting from that action. We would also ask how any tensions between prudential objectives and the FCA consumer protection and efficiency and choice objectives would be resolved.

5 Do you have any comments on the detailed arrangements for the PRA described in paragraphs 2.62 to 2.78 and in Chapters 3 and 4?

See our response to question four above.

6 Do you have any views on the FCA's objectives – including its competition remit - as set out in paragraphs 2.80 to 2.90 and in Chapters 3 and 4?

The Consumer Protection Objective

In the July 2010 consultation *judgement, focus and stability* the Government set out a vision for a financial services conduct regulator that would be a 'strong consumer champion…taking a tougher, more proactive and more focused approach to regulating conduct in financial services and markets'. Citizens Advice warmly welcomed the recognition that consumers of financial services need a stronger, faster and fitter conduct regulator looking out for their interests.

We note the reasons why the 'consumer champion' label raised concerns with the Treasury Select Committee and elsewhere, but agree with the HMT view set out in *building a stronger system* that the FCA should be a consumer champion in the sense of 'putting appropriate consumer outcomes at the centre of the regulatory process'. Citizens Advice also strongly supports the statement in this White Paper that 'at the heart of the Government's proposals will be a more pro-active approach to conduct regulation, with a clear focus on consumer outcomes'.

However we cannot see this commitment clearly reflected in the consumer protection objective that the Bill currently gives the FCA, which leaves the existing FMSA text basically unchanged. In particular we note that the list of 'have regards' defining the 'appropriate degree of consumer protection' has not been amended to include any reference to consumer outcomes.

We recognise that the FSA has significantly changed its philosophy in recent years and warmly welcome the new approach to conduct regulation launched by the FSA in 2010. The intention to be more pro-active. intervening earlier to choke off consumer detriment before it occurs represents a significant improvement in consumer protection; as does the greater focus on consumer outcomes and the use of intensive and intrusive supervision as part of a irsk based approach.

But none of this intent has been written into the legislation setting out the objectives of the FCA. Our concern here is that the culture change described above has come about at a

time of widespread public concern about the need for more effective regulation of the financial services sector. This suggests that the regulatory culture of the FSA has up until now been largely driven by the board and senior management rather than by a clear consumer protection mandate from the Financial Services and Markets Act. As a result the FSA's new approach to conduct regulation is not locked in by FSMA and the consumer protection objective in this Bill will not lock that culture into the FCA.

Therefore Citizens Advice would urge HM Treasury to look again at the 'have regards' list in new FSMA Section 1C(2) and amend this to include some explicit references to consumer protection outcomes. In our written submission to the Joint Committee of the House of Commons and House of Lords we suggested the following additions to the 'have regards' list:

- The need to be pro-active in preventing consumer detriment
- The need to minimise consumer detriment by responding quickly to evidence of problems in the market.

Alternatively, HM Treasury might consider amending the 'have regards' list to include explicit reference to the three goals of the FSA's new approach to conduct that were set out in the speech by Hector Sants on 12th March 2010:

- Making the retail market work better for consumers
- Avoiding the crystallisation of conduct risks (into consumer detriment)
- Delivering credible deterrence and prompt and effective redress for consumers.

If these are the cornerstones of the new approach to conduct regulation that will carry over to the FCA, then surely these goals, or something broadly similar, should be captured in the statutory objectives that the FCA will be obliged to work to. Regulators only use tools to carry out their duties and functions, so it is important that the objectives in this Bill lock-in the changed approach. Otherwise the important new regulatory tools set out in the Bill may not prove as effective at preventing consumer detriment as they might be.

Vulnerable and marginal consumers, the Equality Act and the regulatory principles.

Citizens Advice remains concerned that the FCA objectives are silent on the needs of consumers who are either vulnerable to detriment or at the margins of the market because of the way that firms take account of their needs and personal circumstances.

The consumer protection objective appears to pick these needs up rather weakly by requiring the FCA to 'have regard' to 'the differing degrees of experience and expertise that different consumers have'. We believe that this is too vague and unfocused to ensure that the FCA rules, guidance and regulatory approach pays sufficient attention to the problems faced by people with too little consumer power to benefit from competition in financial services markets and who find it more difficult to get firms to hear their complaints. Furthermore we believe that the needs of this group of consumers will become a more urgent concern for the FCA should responsibility for consumer credit regulation pass to it.

In addition we note that the FSA has been defined as a public body for the purpose of the public sector equality duty under Section 149 of the Equality Act 2010. Assuming that the

FCA takes on this designation, the new conduct regulator will have to have regard to the need to 'eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under' the 2010 Act.

Here we note in particular that Section 20 requires firms to make reasonable adjustments to prevent their business practices putting a disabled person at substantial disadvantage compared to persons who are not disabled. A failure to do so is defined as discrimination by Section 21 of the Act. As a result the duty on the FCA to have regard to the need to eliminate discrimination is a mainstream conduct issue that should be firmly embedded in the FCA's consumer protection objective. But the Bill is silent on this point.

In July 2010 Citizens Advice published an evidence report, *Double disadvantage,* that highlighted the problems that disabled CAB debt clients experienced when their creditors – including FSA authorised firms – failed to make reasonable adjustments in a consistent way. We believe that this inconsistency stems in part from the current lack of explicit reference to equalities issues in conduct regulation.

As a result we believe that HM Treasury should also consider amending the consumer protection objective ' to ensure that the FCA must have regard to these two key consumer outcomes, protecting those consumers most vulnerable to detriment and eliminating discrimination.

Regulatory principles and consumers at the margin

Citizens Advice also notes that the Bill requires the FSA to have regard to the regulatory principle that a burden or restriction it imposes should be proportionate to the expected resulting benefits. We are concerned that this may be interpreted in a way that might disadvantage particular groups of consumers. The costs of an intervention across a market or sector that is necessary to ensure good outcomes for a group of consumers sharing a particular characteristic may appear to outweigh the benefits of the intervention where that group is small in numbers, even though they have or may experience significant and severe detriment.

Therefore we believe that there is a potential for tension between a focus on consumers at the margin of the market and the equality duty on one hand and the cost-benefit regulatory principle on the other.

The Bill does contain provisions allowing the FCA to make rules without consulting on cost-benefit analysis if the FSA considers that the *delay* would be prejudicial to the interests of consumers. But we are not clear whether there is an equivalent waiver of cost-benefits in order to meet an equality objective or protect a group of consumers whose relationship with a firm or firms is particularly vulnerable to causing detriment. Therefore we would ask HM Treasury to consider amending the waiver in new Section 138M to take account of this.

The efficiency and choice objective

Citizens Advice believes that the meaning, scope and intent of the 'efficiency and choice' objective is unclear, both in the Bill itself and in connected policy statements by the Government and the FSA. As a result we believe the Bill does not provide certainty about

the extent of the FCA's role in ensuring that choice extends to consumers that financial services markets would otherwise under serve or serve poorly with inappropriate products.

The efficiency and choice object appears to be the only driver in the bill capable of committing the FCA to ensuring that lower income consumers are able to access essential financial services that meet their needs without being exposed to excessive costs and charges.

It also appears to be the only statutory basis to implementing the key goal of the FSA's new approach, *making the retail market work better for consumers*, in a way that ensures that the market works better for **all** consumers. In other words we believe that the Bill should make it clear that this is an *inclusive* goal that focuses on the experience of actual real world consumers, rather than consumers as an abstract homogeneous object of regulation.

The February HM Treasury consultation, *Building a stronger system* agrees [at paragraph 4.31]that *financial inclusion* is an important issue that needs to be addressed. It is argued that the *efficiency and choice* objective will give the FCA a mandate to do so, but that a more formal 'have regard' would be inappropriate as this is a matter for social rather than regulatory policy. We are not at all clear about what this distinction will mean in practice, or how social and regulatory policy will be brought together to benefit consumers.

The explanatory notes to the Bill do not provide much more help, with paragraph 77 merely suggesting that the efficiency and choice objective *may* be used to promote choice in the market for basic financial products. The FSA document outlining the future FCA approach also discusses the efficiency and choice objective, locating this almost entirely with the role in promoting competition. But a key issue in financial inclusion debates is the recognition that competition does not always bring benefits to lower income consumers and may even exacerbate the problems they face.

Financial inclusion is something of a catch-all term that could pick up issues for regulatory policy, social policy or both. However Citizens Advice would argue that ensuring that essential transactional services (such as bank accounts, payment services and ATM's) meet the needs of all consumers should be a core function of the regulator.

We would also argue that an effective financial services regulator should have a key role in ensuring that products meeting other specified financial needs of lower income consumers do come to market. In the absence of such a role, financial inclusion initiatives such as HM Treasury work on simple and transparent products have no route to practical implementation and the new product intervention rules may result in firms leaving the market rather than considering the needs of lower income consumers.

Therefore we believe that the efficiency and choice objective should be supported by a clear 'have regard to the need to sure that all consumers have access to essential transactional financial services that they can afford and which meet their needs'.

We would like the Bill to go further, by including an aspirational 'have regard to the need to facilitate access for all consumers to suitable and affordable products' as specified in an order by HM Treasury. This would keep with the Government the social policy aspect of deciding when to intervene to prevent certain consumers' financial needs being

underserved by the market. At the same time it would provide a power for the FCA to operationalise the government's policy intention through its regulatory tools and functions.

Without such amendments we believe that the current wording of the efficiency and choice objective will deliver the FCA with a 'financial inclusion' mandate that is simply too weak to make a difference in practice.

Competition

Citizens Advice supports the measures in the Bill that require the FCA to promote competition. We believe that the lack of a clear role in respect of competition issues probably hindered the ability of the FSA to deal with PPI quickly and effectively.

However we would also reiterate the point made above that competition will not always, by itself, deliver benefits for all consumers; the Office of Fair Trading market study into personal current accounts showed how competitive processes can be experienced differently by consumers in the same market, delivering good outcomes to some (those with significant consumer power) and poor outcomes to others (those without consumer power).

As a result we believe that it is important that the FCA looks at competition and consumer protection together 'in the round', and that it does so from the perspective of different groups of consumers, rather than consumers as an undifferentiated whole. From this perspective standard concerns of competition policy, such as facilitating entry to market must be well balanced by a consumer protection objective that is well focused on consumers at most risk of detriment. Again, we believe that this balance will be particularly important if the FCA takes on responsibility for consumers credit; as we continue to see evidence of low barriers for entry creating opportunities for rogues to prey on financially vulnerable consumers, rather than offering any competitive benefit.

We also support the new Section 345D power of the FCA to make a competition request to the Office of Fair Trading. Although given the FCA status as a broad sector market regulator (and as a matter of regulatory efficiency), we would question whether it might be appropriate to allow the FCA to expedite a reference to the Competition Commission (or a second tier investigation in the proposed new Competition and Markets Authority) where the OFT agrees with this.

7 Do you have any views on the proactive regulatory approach of the FCA, detailed in paragraphs 2.91 to 2.110 and in Chapters 3 and 4?

Citizens Advice warmly welcomes the new regulatory tools that the Bill proposes for the FCA. This appears to be a well thought out package of measures that is well directed at addressing weaknesses in the regulatory regime exposed by consumer problems. An outline of our views on these is set out below.

- **Business model scrutiny:** Citizens Advice welcomes the explicit reference in clause 7(1) requiring an authorised person to satisfy the regulator that their business model or strategy for doing business is suitable having regard to the regulated activities they intend to carry on. We have seen examples of financial services (for instance some sub-prime mortgage lending on right-to-buy properties

and some sale and rent back agreements) that appeared to be potentially harmful by design. The FCA might in future be able to prevent some serious detriment by some early questioning of business models that look likely to produce consumer detriment. This will be particularly important if the FCA takes responsibility of regulating consumer credit, where we have seen several examples of business models that appear unsuitable and detrimental to consumers. For instance, in responding to the recent Citizens Advice super-complaint on marketing and charging practices in the credit brokerage and debt management sectors, the Office of Fair Trading found that 'there are some businesses in the credit brokerage market whose business models are based on taking upfront fees for a service which they are unlikely to be able to provide'. Early scrutiny of business models is an essential part of an effective threshold perimeter and hence a vital part of the regulator's consumer protection tool kit.

- **Enhanced powers to vary and impose requirements on permissions**. Citizens Advice welcomes this proposal. The FCA should be sufficiently nimble to deal with problems caused by a specific firm, product or practice through a quick and decisive targeted intervention that is local to the problem causing detriment. Again we believe that this will be particularly important if the FCA takes responsibility for consumer credit regulation, given the heterogeneous nature of consumer credit market with many niche products and sectors often targeted at financially vulnerable consumers. Our reading of the Bill and explanatory text suggests that the power to vary permissions and impose requirements is intended to do this. However the existing power to vary permissions is fairly opaque from a consumer advocacy point of point of view, so we are uncertain whether this is the purpose of the powers. Citizens Advice would welcome some clarification as to how the FCA might use these powers, particularly as a micro-intervention to deal quickly with specific problems.

- **Product intervention rules:** Citizens Advice strongly supports this power which could help the regulator to address potentially harmful features of a product or service before a large number of consumers become exposed to the risk of harm. Citizens Advice believes that the lack of a power for the FSA to intervene to deal with problems in the design and content of products has been a missing piece of the effective regulation jigsaw. For instance, an early intervention to address unfair and potentially misleading exclusion clauses in PPI products could have prevented some of the mis-selling problems seen by the CAB service. However it is not clear whether the regulator could also use the rules to require firms to ensure that the needs of a particular group of consumers are met. In the absence of such a positive intervention power, would firms respond to the regulators concerns to protect a specified group of consumers by under serving those consumers or excluding them from the market?

- **Financial promotions:** Citizens Advice welcomes the power for the FCA to publicise action it has taken against financial promotions that breach the financial promotion rules. Not informing consumers about action against misleading or otherwise unacceptable financial promotions seems a glaring omission in the current regulatory regime.

- **Publication of warning notices:** Citizens Advice also welcomes the proposal to allow the FCA to disclose information about warning notices. If the regulator is sufficiently concerned about a product, service or practice to consider enforcement action then consumers need to know about this. Enforcement action by the FSA can be a long drawn out process, leaving consumers exposed to potentially harmful practices that the regulator is aware of but they are not. This is not consistent with a pro-active approach to preventing consumer detriment and represents a consumer protection failure. We do not accept that disclosing information about warning notices is likely to have a seriously detrimental affect on firms – we have seen no evidence that publication of final notices about PPI mis-selling, poor practices by mortgage lenders or poor complaints handling by banks has put any of these firms out of business. However earlier publication by the FSA might have encouraged firms to address problems sooner or helped consumers to make better choices. For instance, early notification of poor complaints handling by a firm might encourage consumers to persist with a justified complaint and not be fobbed off.

8 What are your views on the proposal to allow nominated parties to refer to the FCA issues that may be causing mass detriment?

9 What are your views on the proposal to require the FCA to set out its decision on whether a particular issue or product may be causing mass detriment and preferred course of action, and in the case of referrals from nominated parties, to do so within a set period of time?

Both the Government and the FSA talk of the need for more pro-active regulation to deal with conduct issues before these can cause widespread consumer detriment. But the Bill does not currently put the FCA under any clear duty to act in response to evidence of emerging consumer problems. Citizens Advice believes that the lack of such a duty on the FSA has been a key weakness in the current FSMA regime. As a result Citizens Advice strongly supports the introduction of a super-complaint like process for the FCA.

Citizens Advice is a designated 'super-complainant' under Section 11 of the Enterprise Act 2002. This Section allows designated consumer bodies to make a complaint to the OFT where 'any feature, or combination of features, of a market in the United Kingdom for goods or services is or appears to be significantly harming the interests of consumers'. We have used this power three times since its introduction, on door step selling, on payment protection insurance and most recently on charging and marketing practices in the credit brokerage and debt management sector.

In each case we have found that the super-complaint process has been vital in getting the regulator to look at a serious issue that might not otherwise have been addressed. The super-complaint process covers a number of *economic* regulators, but it does not cover the FSA. Citizens Advice believes that had we been able to make our super-complaint on payment protection insurance to the FSA and OFT jointly (the complaint raised both conduct and competition issues), the conduct issues may have been addressed more quickly and effectively.

Our experience as a super-complainant suggests that a super-complaint like process for the FCA would need to have three elements to be successful:

1. **Establish a right for designated consumer bodies to make a complaint to the regulator:** The grounds could be similar to the current Enterprise Act criteria of a feature or features of a market that 'is or appears to be significantly harming the interests of consumers'.

2. **The regulator must be placed under a duty to make an initial response to the complaint within a specified time frame:** By way of reference, the Enterprise Act gives the OFT 90 days. A duty to respond within a specified time limit is a key component of the process as otherwise the regulator could just ignore the complaint. Importantly, the 90 day response does not necessarily require the regulator to set out in detail how they would resolve any problem (though the regulator might do so). The Enterprise Act only requires the OFT to state how it proposes to deal with the complaint and the reasons for its decision. If it decides to act it must say what action it intends to take. If it decides no action is necessary it should state the reasons for this conclusion.

3. **Where the FCA finds that the interests of consumers are being harmed, it should be placed under a duty to resolve the problem as far as reasonably practicable within a second specified time limit.** The Enterprise Act does not require the OFT to remedy any problem that it finds. Instead it sets up a second process allowing the OFT to refer a problem onto the Competition Commission. However once a referral has been made the Competition Commission is under a duty to investigate further and report its conclusions within a two year time frame. Perhaps most important of all, the Enterprise Act (Section 138) puts the Competition Commission under a duty to 'take such action… as it considers to be reasonable and practicable… to remedy, mitigate or prevent any detrimental effects on customers…' that it finds.

Citizens Advice believes that the FCA should be placed under a similar 'second stage' duty to resolve consumer problems so far as is reasonable and practicable. However a shorter period for the second stage might be more appropriate for the FCA (We understand that the Competition Commission is required to start their inquiry afresh rather than relying on prior work by the OFT; such a consideration would not apply to the FCA).

To conclude, we believe that a super-complaint like process is an innovation that would lock-in and guarantee a culture of proactive regulation at the FCA. It provides a means for a direct and practical accountability to consumers, ensuring that the regulator deals with emerging consumer problems quickly and effectively.

10 Do you have any comments on the competition proposals for the FCA set out in paragraphs 2.111 to 2.119 and in Chapters 3 and 4?

Please see our answer to question six above.

11 Do you have any views on the proposals for markets regulation by the FCA, described in paragraphs 2.120 to 2.123 and in Chapters 3 and 4?

Citizens Advice has no comments in response to this question.

12 Do you have any comments on the governance, accountability and transparency arrangements proposed for the FCA, as described in paragraphs 2.124 to 2.132 and in Chapters 3 and 4?

We have partly answered this question in the responses above. Our primary concerns about governance, accountability and transparency arrangements relate to the objectives that the Bill gives the FCA and the opportunity for direct accountability through a super-complaint process.

13 Do you have any comments on the general coordination arrangements for the PRA and FCA described in paragraphs 2.138 to 2.149 and in Chapters 3 and 4?

Citizens Advice has some concerns about the way that the Bill appears to give the Prudential Regulation Authority seniority over the FCA. While we are reasonably reassured that the PRA veto over FCA decisions in new Section 3H is intended to be used only in very exceptional circumstances, we are not sure how more day-to-day tensions between the approach of the two regulators will be resolved in a way that does not undermine consumer protection.

By way of example, the FSA recently published draft guidance on prudential regulation aspects of the way that mortgage lenders deal with accounts in arrears. This described approaches to issues like the sustainability of forbearance arrangements in a way that could potentially (and unnecessarily) undermine other work by the FSA and other Government departments to support homeowners with mortgage arrears. The point here is that some tensions between prudential and consumer protection approaches are already apparent within the FSA. We would ask the Government to consider further how these tensions would be successfully resolved under a ‘twin peaks’ system.

14 Do you have any views on the detail of specific regulatory processes involving the PRA and FCA, as described in paragraphs 2.150 to 2.195 and in Chapters 3 and 4?

We have addressed this question in our other responses.

15 Do you have any comments on the proposals for the FSCS and FOS set out in paragraphs 2.196 to 2.204 and in Chapters 3 and 4?

Citizens Advice strongly supports the Government’s commitment to retaining an independent alternative dispute resolution body in the shape of FOS. From our point of view as an advice charity helping many, often disadvantaged, people to deal with problems with financial services, the Financial Ombudsman Service has been one of the most successful aspects of FSMA.

FOS provides an accessible, fair and straightforward means for consumers to seek redress when they do not think that their complaint has been deal with properly by a firm. This has been a huge benefit to CAB clients who are often in financial difficulties or lack the skills, confidence and resources to challenge unfair practices by financial services

providers. Without the intervention of an independent and free- to-consumer third party adjudicator their problems would not get a fair hearing, reducing trust and confidence in the financial services sector. We have also been impressed by the work FOS is doing to ensure that hard-to-reach consumers have access to ADR.

Citizens Advice also strongly supports the proposals in Schedule 10 (new FSMA Section 230A) requiring the ombudsman scheme operator to publish reports of determinations. We believe that this will help build trust and confidence in the financial services sector in two ways:

- Greater transparency on FOS decisions will give firms a greater insight into the cause and nature of consumer problems across the market. This will help firms reflect on their products, practices and procedures so they can pick up and resolve consumer detriment earlier; a benefit to both firms and consumers.

- Publication of FOS decisions will also help give consumers a better sense of what fair and unfair treatment looks like. Knowledge of other people's disputes and how these were resolved by FOS will help consumers to better reflect on their own situation. This might prompt some consumers to complain who would not otherwise have done so. Given recent work from the OFT showing how consumer complaints are a key driver of firm's compliance with consumer protection, this should have a positive effect on conduct in the market. But it will also help consumers to better understand grievances that have not been upheld by the Ombudsman. This could also help prevent unnecessary complaints and some of the predatory practices that Citizens Advice has seen from some claims management companies that have caused significant detriment to consumers.

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8 September 2011

Dear Sirs

Re: CLLS Regulatory Law Committee response: A new approach to financial regulation: the blueprint for reform

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 the HM Treasury Consultation on "A new approach to financial regulation: the blueprint for reform" has been prepared by the CLLS Regulatory Law Committee (the "**Committee**"). Members of the Committee advise a wide range of firms in the financial markets including banks, brokers, investment advisers, investment managers, custodians, private equity and other specialist fund managers as well as market infrastructure providers such as the operators of trading, clearing and settlement systems.

Introduction

The publication of the White Paper and the draft legislation has provided some more information as to how the Government sees the new regulatory infrastructure, but, taken in the round, the draft legislation provides a scant framework for a fundamental reform which will replace a "tripartite" model of financial regulation with one which has four regulatory bodies. Efficient and effective interaction and co-ordination between these bodies will be critical. This is not only to ensure a 'safe' system of regulation, but also to reassure regulated firms that they will neither be paying for an inefficient duplicative system, in particular one which requires them to provide broadly the same information to more than one regulator, nor at risk of being caught in a cross fire of disagreement or perimeter disputes between regulators. In a crisis situation the interaction between the various bodies will be critical. In particular, we would highlight the following as areas where more detail is required in the primary legislation:

- We do not think that the draft legislation provides adequate underpinning for the interaction between the regulators. The new arrangements are scarcely more clear and binding than the existing tripartite arrangements and involve considerable reliance on an inter-regulator Memorandum of Understanding, and this does not inspire confidence. The objectives of and the fundamental elements that must be covered by any Memorandum of Understanding between regulators should be stated on the face of the legislation, or in secondary legislation. It should not be for regulators to decide what should be covered.

- Similarly, the regulatory scope of the PRA should be based on clear, transparent principles stated in the law; it should not be a matter for its discretion.

- The proposals split the regulation of exchanges from that of the clearing and settlement systems which settle the transactions executed on exchanges and lack clarity on the responsibility for settlement finality designations.

There is also a real risk that the structure will decrease the effectiveness of the U.K. voice in Europe at a time when there has been a considerable shift of power to the European regulatory bodies. There must be much more clarity as to how the regulators will interact to provide a coherent and effective European voice, as it is our understanding that although there are effectively four regulators, the U.K. has only one seat on each European Supervisory Authority.

We are also concerned that the proposals include substantial extensions of enforcement processes and publication of decisions with little protection for the regulated person, for example:

(1) directions in respect of financial promotions: there does not appear to be any prior consultation (or other process engaging the authorised person) before the FSA gives the direction and publishes it;

(2) publication of a warning notice requires only that the target person(s) be consulted and sets some criteria of substance for a decision not to publish - but again neither sets out or requires any additional process or protections.

Indeed, the amendments proposed further dilute the protections that already exist in relation to the giving of warning notices, decision notices and supervisory just as the potential effect of such actions is being magnified by changes such as the two referred to, above. There will continue to be no requirement for the regulator to consult on the statement of procedure it is required to issue under section 395(5). At the very least in light of the changes proposed, the regulators should have to consult, but more than that, Treasury should be required to set minimum standards for such procedures.

We repeat below some of the comments we have made previously, even though they have not yet been taken into account. Where we do so this is because we consider the matter to be one of considerable importance, whether because it raises fundamental issues of natural justice and fair procedure and/or because it has negative implications for the position of the U.K. as a financial centre compared with other major European cities.

Box 2.A: Consultation question
1 Do you have any specific views on the proposals for the FPC?

As set out in our response dated 14 April 2011 to the consultation "A New Approach to Financial Regulation – Building a Stronger System" (CM8012) we express no view on the creation of the FPC as a matter of principle. We note that the draft Bill reflects very closely the proposals in the previous consultation and for that reason some of our comments set out below are very similar to the comments we made in our April response.

The FPC's proposed objective and Treasury control

The FPC's objective links into the Bank of England's revised financial stability objective of protecting and enhancing financial stability in new section 2A of the Bank of England Act 1998. In the absence of a detailed definition of "financial stability", we consider that the provisions of the Bill referred to below make insufficient provision for Treasury control and contain insufficient constraints on the FPC.

Section 9A(2) provides that the Bank's Court of Directors must consult the Treasury about a draft of the Bank's financial stability strategy but is silent about the weight to be accorded to any recommendations made by the Treasury. We consider that this should be made explicit, probably by a “comply or explain” provision of the type included elsewhere.

New section 9(C)(1) provides only for the FPC to exercise its functions "with a view" to contributing to the achievement of the Bank of the Financial Stability Objective. This appears to suggest that the FPC may potentially have other objectives in mind as well so long as its aims include contributing to the Bank's Financial Stability Objective. In any event, it appears to set the FPC a very low target to meet (though we generally welcome the requirement in section 9S(4)(b) for a financial stability report to include an assessment of the extent to which the FPC has succeeded in meeting its objectives).

We note that in proposed new section 9(C)(4) the Government has proposed a balance between financial stability and sustainable economic growth in the terms set out in Box 2B of the previous consultation. The new provision, by its breadth and subjectivity, grants the FPC a wide measure of discretion to exercise its functions in a way that may have a significant effect on the UK's economic development. We remain of the view that the latitude accorded to the FPC is too wide.

While the Treasury may at any time make recommendations under new section 9(D)(1) as to matters the FPC should regard as relevant to its understanding of the Bank's Financial Stability Objective, its responsibility in relation to the achievement of that objective or matters to which the FPC should have regard in exercising its functions, the FPC is not required to comply with the Treasury's recommendations. It is simply under an obligation to notify the Treasury whether or how far it accepts the recommendations and what action (if any) it proposes to take in response to them. We note also that no provision is made for the Treasury to make recommendations about matters which the FPC should not regard as relevant. We consider that the Treasury should expressly have this power. While in practice the FPC may generally follow the Treasury's recommendations, we consider that greater weight should be accorded to the Treasury's recommendations on the face of the Bill and, in

this regard, we note the disparity between the Treasury's powers in relation to the FPC and the FPC's powers in relation to the PRA and FCA.

Finally, we note that in section 9E(1) in the exercise of its functions the FPC must "have regard" to the Bank's financial stability strategy. When taken together with the provisions referred to above, we consider that this creates uncertainty about the full extent of the FPC's functions and the controls over it.

Exercise of functions

From the point of view of the regulated financial services community there is likely to be uncertainty as to the extent to which statements or indications by the FCA or PRA as to future regulatory policy can be relied upon in view of the ability of the FPC to override them. Section 9(A)(2) provides for the FPC to strike a balance between contributing to the achievement by the Bank of the Financial Stability Objective and the advancing by the FCA of any of its operational objectives or the advancing by the PRA of its objectives. However, the provision strikes a balance in such a way that it is likely to enable the FPC to override the FCA and the PRA. The Bill contains a number of provisions for communication or consultation between the various public bodies subject to the provisions of the Bill. There is, however, in this case no mechanism provided by which the FPC will take into account the views of the PRA and FCA in striking a balance between the Bank's Financial Stability Objective and the objectives of the PRA and FPC. The absence, for example, of a duty to consult renders it unclear how the FPC will assess the existence and extent of any potential prejudice to those objectives.

As we have previously commented, the provisions in relation to proportionality (found in new section 9(E)(3)) omit certain elements of the requirement. The formulation of proportionality does not include the requirement that a measure should generally go no further than necessary in order to achieve the legitimate aim being pursued. Furthermore, the provision gives no guide as to how the balance should be struck and who should be taken into account for the purpose of assessing the benefits that are expected to result. Finally, the obligation of the FPC under new section 9(E)(3) is only to "have regard" to the matters set out in that provision. The effect is that the obligation on the FPC to act in a proportionate manner is weakly cast. It needs to be strengthened to give market participants confidence in the integrity of the FPC's exercise of its functions.

Strengthening the requirement in relation to proportionality would give greater comfort that the FPC will exercise its functions in a graduated way. At present, there is no express provision as to how the FPC will choose which of its various powers it will exercise. In this regard we note that in relation to directions by the FPC under new section 9(G), an order by the Treasury under new section 9(K) may, in relation to a prescribed type of measure, require the FPC to maintain a statement of the general policy that it proposes to follow in relation to the exercise of the particular power of direction. Although the giving of directions by the FPC may be relatively rare, given the real consequences that are likely to flow from the making of a direction, we consider that new section 9(K)(4) should provide for the Treasury to be required to impose an obligation on the FPC to maintain a general policy statement in relation to the exercise of the direction-making power.

Accountability

Paragraph 2.28 of the previous consultation indicated that the Government proposed to legislate to exclude individual regulated firms from the FPC's powers, while recognising 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 a systemic risk. New section 9(G)(4) sets out that a direction may relate to all regulated persons or to regulated persons of a specified description but may not relate to a specified regulated person. While such provision is welcome, it does not really address the concern that the FPC may effectively stray into taking firm-specific decisions that are properly part of the functions of (most likely) the PRA. No provision is made on the face of the Bill in relation to the rights of systemically important institutions to challenge measures that are directed specifically at them. As noted in our previous response, some of the macro-prudential interventions proposed could (if they were effected by the FSA under the current law) require the use of its OIVoP power under section 45 of FSMA if directed at individual institutions (with the corresponding right to refer the matter to the Tribunal). In practice, given the wide extent of the FPC's discretion and the high threshold for successfully bringing an action for judicial review, there may be little that the relevant institutions may do to secure the accountability of the FPC. While we understand that the Government would be likely to have concerns if a delay in the FPC's directions being given effect could have adverse consequences for financial stability, we do not consider new section 9G(4) provides sufficient safeguards. In addition, we consider that at the very least there should be a general presumption under new section 9(H)(2) that where a regulator is complying with a direction by the FPC, the usual procedural requirements will apply – or, at least, they will apply unless there would be a serious risk to financial stability caused by taking time for consultation.

Similarly, we note that new section 9(J) gives the Treasury a discretion whether to publish a direction under new section 9(G). If a direction is not published, it may make it extremely difficult for those affected by the resulting measures put in place by the PRA or FCA to review those measures against the relevant provisions of FSMA applicable to them. The presumption under section 9(J) should be in favour of publication, with the possibility of suspending publication only for so long as is necessary in the interests of financial stability.

Box 2.B: Consultation question

2 Do you have any specific views on the proposals for the Bank of England's regulation of RCHs, settlement and payment systems?

Changes to the recognition regime

The changes to the Financial Services and Markets Act seem to us to produce quite wide ranging philosophical changes in relation to the status of recognised bodies. These changes are however given a very low profile and no real explanation in the accompanying text. Whilst we recognise that markets have developed since the recognition regimes were introduced, we believe that they are still important and we are unaware of any failings in those regimes of a kind which would prompt significant change to them. The consultation paper makes no reference to any such failings. Other countries draw regulatory distinctions between those entities that are part of the central infrastructure required for the successful operation of their markets (i.e. exchanges and clearing houses) and distinguish them in a number of ways from other firms. At a European level MiFID clearly recognises that regulated markets, central counterparty, clearing and settlement facilities are not the same as investment firms and makes fundamentally different provision in relation to them. We think that the UK is out of step with other jurisdictions if it seeks to reduce the status of its own recognised bodies.

Under the present law the FSA has a wide range of powers in relation to the recognised bodies, which themselves have some regulatory functions, as recognised by their immunity in connection with the exercise of those functions. We believe that a much fuller discussion of the proposed changes would be appropriate before any decision is made to make them. In particular, we question proposals that would subject such entities to the potential of financial penalties and public censure. Have there really been situations where the absence of these penalties or powers has caused an issue, or is it realistically anticipated that there could be any such possibility? It seems to us to send an entirely different message about the status of these bodies from that which has to date been conferred by "recognition" status.

The paper provides no insight into the reasoning behind any of the changes proposed. The effect of the new structure will also be to fragment the regulation of key parts of market infrastructure which are interdependent, yet there is no detail at all on how the Bank of England, which will oversee payment systems and recognised clearing houses, will interact with the FCA which will be responsible for recognised investment exchanges. We also note that recognised investment exchanges may themselves also wish to provide clearing services, as indeed they have done historically. Only last week the LSE was reported to be in talks to buy LCH Clearnet.

We believe that any further changes to the recognition regime should await European developments (including the proposed MiFID II, EMIR and CSD measures) and that there should be no change to the UK regime in the interim.

Clearing services

We were surprised by a number of references in the paper which seem to equate clearing services with central counterparty services. For example, the statement "CREST (currently an RCH although it is not a central counterparty)", implies that HM Treasury is adopting a much narrower concept of clearing than that which has applied in the UK to date and indeed, which applies internationally. The European Commission produced a paper some time ago which sought to define services provided within the clearing and settlement value chain. We broadly agree with the analysis in that paper. This states that:

> *"After the execution of buy and sell orders, transactions are processed in preparation for the transfer of ownership of the product and the fulfilment of all obligations. Depending on the institution providing this service, several additional services are performed, such as the netting of obligations to ensure fewer processes and cash flows, and in particular the evaluation and management of all relevant sources of risk in order to reduce the probability of failure to meet obligations.*
>
> *In most cases, this function is performed on different levels; firstly by trading parties for their clients, secondly at central counterparty clearing houses (CCP clearing) and thirdly its central securities depositaries (CSD/ICSD clearing)....with regard to the various different clearing levels, it has to be taken into consideration that the clearing performed by a CCP is different from that performed by a CSD. CCP clearing concentrates on trade management, position management, collateral and risk management, and delivery management...CSD clearing concentrates on validating and matching the delivery instructions; the result of which is forwarded to settlement."*

It is clear on this basis that the CREST operator carries on both a clearing and a settlement function, which has always been the view of the authorities, the fact that it is not a central counterparty is of no relevance to the analysis. We therefore consider that it is a recognised clearing house and should be regulated as such by the Bank of England. It is a critical part of UK infrastructure, according to its website over £3.3 trillion of securities are held and transferred through the CREST system. It is surprising therefore, given its importance to the UK infrastructure and the fact that it has been a recognised clearing house from the day it was established, that there should be any doubt as its categorisation or its regulation.

European representation

The FCA has the UK seat on ESMA. We think it is important that the arrangements for interaction between the Bank of England and the FCA in respect of recognised bodies be clarified, if the FCA is to have a role in relation to recognised investment exchanges but not recognised clearing houses. Yet there will be significant developments on the European front which could affect recognised clearing houses. It will be essential that the FCA is properly equipped to represent the UK on these issues.

Other comments

We have the following additional comments:

1. We support immunity from liability in damages for the operator of systems under the Uncertificated Securities Regulations. At present the mismatch between this and the recognised clearing house regime gives rise to legal uncertainty;

2. We support the new powers proposed in respect of payment systems

3. We do not think that Schedule 17A paragraph 8 can be correct, financial instruments are not traded on a recognised clearing house, trading has already occurred, and therefore the notion of suspending or removing a financial instrument from trading has no application in this context. We do not in any event consider that a recognised clearing house is an institution within the meaning of new section 313A.

4. It is not clear to us what the intentions are in relation to settlement finality designation, as currently the FSA is responsible for designating systems operated as a recognised investment exchange or recognised clearing house. There is a need to tie up settlement finality designation with the division of responsibilities between the Bank of England and the FCA.

Box 2.C: Consultation question

3 Do you have any comments on:

- the proposed crisis management arrangements; and
- the proposals for minor and technical changes to the Special Resolution Regime?

Crisis management

As indicated in our earlier response, there is a fundamental need for coordination across the authorities in a crisis management situation. Creating clarity of roles and a requirement to enter a memorandum of understanding are welcome first steps, but are insufficient on their own to create the conditions for effective coordination.

Statutory provisions and a change in structure are not sufficient conditions to coordinated crisis management however. Effective coordination of crisis management requires the authorities to ensure cooperation and mutual understanding – and more critically it involves careful preparation and planning.

The interaction between the Bank and the PRA in advance of a crisis situation will be key to how successfully it is resolved. The creation and role of the Bank of England Special Resolution Unit in the FSA Recovery and Resolution Plan pilot has been a useful first step to better coordination between the authorities, and to more considered preparation for crisis situations. It is clear that more needs to be done to prepare the authorities for future crisis situations. This is likely to include assessment and transmission of relevant information between PRA and Bank staff as a firm nears crisis; war gaming failures of specific firm failures; and engagement of Bank staff through the implementation of firms' recovery plans (to enable consequential amendments to resolution planning). Consideration might also be given to a programme of secondment between the PRA and SRU.

We necessarily defer comment on the quality of the memorandum of understanding until it is published.

Special Resolution Regime

We welcome the proposed changes to the Special Resolution Regime proposed in clauses 59, 61 and 62 and have no comments on these. As a general point we welcome the willingness of the Government to limit the override powers relating to trusts in section 34(7) of the Banking Act. However, we believe that the changes proposed to section 34(7) (the "trust override") leave too much latitude to the Bank.

There has been justifiable criticism of the trust override power: the power gives rise to considerable legal uncertainty on the part of market participants as to how (rights in) trust property would be affected on a resolution, and is not justified by the needs of the authorities. The purpose of the override is to enable transfer with minimal damage to contractual and property rights – either of trustees or beneficiaries – and it is right that the power should be strictly limited to what is necessary to enable that to occur. To this end the new proposed subsection (8) is welcome: but it should apply not just to subsection 34(7)(a) but also subsection 34(7)(b). Further, we would question whether it would ever be justifiable for the Bank to remove (terminate) the terms of a trust in the exercise of its powers: we would therefore suggest the deletion of the words "or remove".

The Prudential Regulation Authority

Box 2.D: Consultation question	
4	Do you have any comments on the objectives and scope of the PRA?

Box 2.E: Consultation question

5 Do you have any comments on the detailed arrangements for the PRA?

Objectives and scope

General objective

We are pleased to note that section 2B(2) and (3) FSMA would in effect contain two distinct operational objectives concerning: (1) the promotion of safety and soundness of PRA authorised persons; and (2) seeking to minimise any adverse effect that the failure of a PRA authorised person could have. As mentioned in our response to the previous consultation (A new approach to financial regulation - building a stronger system) it is incorrect to say that the promotion of the safety and soundness of PRA authorised persons "includes" seeking to minimise any adverse effect that the failure of that person could have on the UK financial system.

However, we are disappointed that the objectives are expressed in such bland terms, indeed in words that connote duties, actions and performance rather than aims. Given the express terms of section 2F, which limits sections 2B to 2D to emphasise that the PRA is not required to ensure that no firm fails, we consider that its objectives should be expressed as such, by deleting the references to "promoting" and "seeking" in sections 2B(2) and 2B(3)(b), to leave:

- "the safety and soundness of PRA authorised persons" and
- "minimising the adverse effect that the failure of a PRA-authorised person could be expected to have on the stability of the UK financial system".

The latter is critical as the test of success is surely whether adverse effects were minimised rather than whether the PRA merely sought to minimise them.

We question also the term "safety" in the general objective (section 2B(2)). It is unclear from what kind of risk (financial collapse, crime, etc) PRA firms are to be safe and for whose benefit (consumers, shareholders, society at large). A term more focussed on the risks (such as "financial strength") or clarification of the relevant stakeholders would help.

One approach to consider would be to base the objectives on the text of section 2B(3) (a) and (b) and add an objective similar to the specific insurance objective:

- Securing an appropriate degree of protection for those who are or may become depositors or other consumers of financial services.

See further on this below.

Another substantial point arises from section 2B(4). We would submit that the reference to adverse effect should include some notion of materiality, either by qualifying the reference itself ("material adverse effect") or by clarifying inter alia that a mere increase of risk is not necessarily an adverse effect.

Insurance and additional objectives

We welcome the new section 2C FSMA concerning the PRA's insurance objective. However, we are concerned about several aspects arising from the relative priorities and scope of this and other objectives.

'Equal priority' between this objective and the general objective could lead to compromises that may not truly satisfy either objective. We note that the creation of additional objectives is envisaged under section 2D FSMA and it is therefore important that both the regulator and the market have a clear understanding as to how conflicts or inconsistencies between the objectives are resolved. Whilst section 2H envisages the PRA publishing guidance regarding the discharge of its own objectives, this obviously creates a conflict of interest in the PRA; and it would be better if further clarity were provided for in the primary legislation itself (or by Treasury in a statutory instrument). In particular:

- it should not be for the regulator to determine its own scope (even in consultation with the other – which in any event could still lead to conflict or inconsistency); and
- in any event it is not appropriate for PRA guidance to be capable of extending or curtailing the scope of such important provisions as objectives.

Given Treasury's power under section 3G to establish the boundary between FCA and PRA, and the affirmative resolution required, the exercise of article 2H powers under 2H(1)(b) should require consultation with Treasury. And, consistent with section 3G, the provisions should refer to "...its, or primarily its responsibility..."

Since a key focus of the reforms is stability, the insurance objective and any other "specified objectives" should be subordinate to the general objective except in two ways:

- in respect only of the *financial supervision* of insurance and reinsurance undertakings, Solvency II will require the main objective to be protection of policy holders and beneficiaries (article 27), but nevertheless that the financial supervisor duly considers financial stability (article 28);
- to the extent otherwise provided in an order passed by affirmative resolution.

There has been insufficient attention paid to the implications of the insurance objective for the general objective. For example, why should not deposit holders be expressly mentioned as a focus of protection? This reinforces the point made above, though we recognise that any broad objective should be conditioned to an extent by reference to prudential regulatory issues rather than issues within the FCA's purview.

As to the wording of the insurance objective in section 2C(2), we have two concerns:

- "contributing to.." is weak and bland in the same way as the "promoting" and "seeking" in the general objective: if "contributing" is intended to refer to the fact that the FCA may have some responsibility in this area, that should be made clear, otherwise the objective should be simply "securing..." and section 2F would ensure this would not be construed as implying no failure of an insurer or reinsurer;
- further clarification is required on the meaning of the term "appropriate degree of protection". One can read appropriate as 'proportionate'. What is clear is that this is

not the idea of policyholders' reasonable expectations which was a terminology used before FSMA. Here PRA guidance under section 2H, on how it will construe the objective, is critical, as is clarification that it excludes conduct issues which are properly the FCA's concern.

Regulatory principles

Innovation: We would again urge the Government to reconsider its position not to include as a principle the desirability of facilitating innovation. 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 they may pose. We repeat that the principle should be included and consideration given to its reformulation.

Mutuality: We welcome the 'diversity have regard to' provision contained in new section 138L FSMA concerning mutual societies. However, whether this will prove to be useful to mutual societies depends upon the level of detail that will be set out in the regulator's statement. We note that the legislation uses the words "significantly different" but it is not clear what exactly this means. If the Government is serious about promoting mutuality, we suggest that the desirability of promoting the development of mutual societies be added as a principle in section 3B.

Competition: We welcome the Government's action to update the existing competition scrutiny regime which will apply to both the PRA and the FCA. Whilst the Bill provides for a competition link to the FCA's strategic and operational objectives (new section 1B(4) FSMA) it is strange that there is no competition link in the case of the PRA's objectives or principles. Competition is a key issue in light of the plethora of prudential regulatory changes since the financial crisis (including those still to come).

Scope in relation to investment firms

With regard to investment firms, we would repeat the point made in our previous response that there is a clear conflict of interest in permitting the PRA to determine the scope of its own jurisdiction in relation to particular investment firms. Certainty of approach is the most crucial issue for firms that have permission to deal as principal. The test needs to be both clear and objective. This is so both for firms currently based in the U.K. and for overseas firms deciding where to base European or global headquarters. They need a clear answer as to what their position would be if they were to choose London. If their first encounter with trying to understand the U.K. regulatory landscape produces an impression of vagueness and subjectivity as to how they will be treated, they will opt for jurisdictions with clear transparent structures. We would submit in particular that:

- Since the express intention (as stated in paragraph 2.57 of the White Paper) is to capture systemically important investment firms, the Treasury should lay down criteria to assess this (as have been developed in other fora (such as the BIS/FSB) and jurisdictions (such as the US where, under the Dodd-Frank Act, the new Financial Stability Oversight Council has been consulting on factors to consider in respect of different types of financial institution). We note that the FSA has recently published a consultation paper concerning recovery and resolution plans and it is proposed that some of the larger investment firms be required to prepare such plans. Subject to the overriding need for proportionality, we suggest that the criteria for both (i.e. PRA regulation of investment firms and the need to prepare such plans) be the same. Unless clear and objective criteria are to be specified in the Act or a statutory

instrument, then the Act should set a clear and transparent process for determining whether any particular firm is required to be PRA-authorised.

- Minimum criteria for and at least some of the criteria comprising the "procedural safeguards" referred to in paragraph 2.58 of the White Paper should be specified in the Bill, and the Treasury should be delegated responsibility for making orders detailing them. Those orders should be subject to the affirmative resolution procedure. Again, the US has a defined process to designate particular non-bank firms as systemically important.

- Safeguards should include, for example, protection against a change of regulator more than once in any defined period (3-years, for example), unless there is a major and transformative change in the firm.

Detailed arrangements

The existing framework under FSMA, which provides for a reference to the Upper Tribunal, is an important safeguard which has the advantage of being backed by an existing body of learning and practice. We welcome the Government's decision not to narrow the grounds of appeal.

Whilst leaving the Upper Tribunal's scope of review of supervisory decisions unchanged, the Government has proposed to limit the course of action available to the Tribunal in the event that it chooses not to uphold the regulator's decision. Other than in limited situations, the Tribunal will not be able to substitute its opinion for that of the regulator as to the regulatory action to be taken. The Tribunal will instead be required to remit the decision back to the regulator with such directions as it considers appropriate in relation to a range of findings. Paragraph 2.66 of the White Paper suggests that the PRA will have some latitude when following an Upper Tribunal direction. However, this does not appear to be the case in the legislation as new section 133 (6)(b) FSMA provides that the regulator will receive a direction to reconsider and "reach a decision in accordance with the findings of the Tribunal." We would highlight two potential issues. Firstly, there is an inherent conflict of interest on the basis that the PRA will have an interest in minimising the Tribunal's changes to its original position. Secondly, there are costs and timing implications for firms that will have to renegotiate with the PRA once the Tribunal has made its decision.

In the context of an approach under which the PRA will make greater use of principles, we again flag the importance of consulting on principles and any associated guidance issued by the PRA as well as on rules made by it. We are pleased to note that the Government intends to mainly replicate the existing consultation requirements set out in FSMA. We are also pleased to see that the Government is also not making an exception from the consultation requirements for those rules originating from Europe.

However, the White Paper states that there may be instances where the PRA may prepare an 'analysis' of costs and benefits rather than an estimate, where such costs or benefits cannot be reasonably estimated or it is not reasonably practicable to produce an estimate (see section 137K(8) FSMA). Whilst we note the safeguard inserted into the section that the PRA must include a statement of opinion where an analysis is used, it is difficult to see a regulatory justification for this change and can only assume that it is a cost saving measure. In addition, we note that the Government still uses the word "significant" in new section 137K(5) and it is still unclear to us what precisely this means.

In new section 137K FSMA the PRA is required to consult with the Treasury and Bank of England concerning the adequacy of resolution plans. Having been consulted the Treasury or the Bank of England may notify the PRA that in their opinion the plan is unsatisfactory. We note that new section 137K(4) FSMA provides that the PRA is to only "have regard" to the Treasury and/or Bank of England opinion and may nevertheless still approve the plan. We would question exactly what the circumstances would be where the PRA would approve a resolution plan which has been previously rejected by the Treasury or the Bank. It is perhaps for consideration whether the Bank and/or the Treasury should only be involved in relation to systemically important financial institutions where public money is at risk.

We refer to paragraph 2.68 of the White Paper dealing with the governance of the PRA and new schedule 1ZB FSMA. Paragraph 18 provides that the PRA must maintain satisfactory arrangements for recording decisions made in the exercise of its functions and for the safekeeping of records that it considers ought to be preserved. The PRA's record keeping requirements will be a particularly important aspect of its governance and we query whether "satisfactory arrangements" are sufficient. In a judgement based approach to supervision there will be a greater need for the PRA to record in sufficient detail the reasons for its decisions. Indeed it should be required to do so. Records of previous decisions will need to be properly safeguarded and made easily accessible to PRA staff to ensure that decisions are consistently applied.

We note that paragraph 2.77 of the White Paper states that the Government will consider further the arrangements for PRA engagement with practitioners during the consultation and pre-legislative scrutiny. We welcome the Government's commitment to ensure that the PRA will engage with practitioners and that such engagement is transparent. We look forward to commenting on the Government's proposals. However, at this stage we can see no policy reason as to why the PRA is not required to establish a practitioner panel and believe that its absence will significantly weaken the regulator. We can see a case for the scope of the FCA practitioner panel (new section 1I FSMA) encompassing common areas between the PRA and FCA but this would not cover solely prudential issues.

We note that the White Paper states at paragraph 2.78 that the Consumer Panel will not be retained and that the PRA will consult the FCA to take advantage of its expertise in consumer issues. The FCA will be required to maintain a Consumer Panel as the FSA currently does. It is clear that the PRA will be making decisions that will have implications for consumers and it is therefore vital that mechanisms are established to ensure adequate consultation between the PRA and the FCA in this context and specific reference should be made in the MoU.

We are disappointed to see in paragraph 2.106 that the Government is pushing forward with the proposed new powers concerning the publication of warning notices. This new power will be made available to both the PRA and the FCA and we have commented further on this in our response concerning the FCA. However, in relation to the PRA we find it strange that new section 391(6) FSMA gives the FCA the right not to publish a warning notice where such publication would be detrimental to the stability of the UK financial system but that this safeguard is not replicated in section 391(6A) covering the PRA. Whilst we note that one of the safeguards for the PRA concerns publication being detrimental to the safety and soundness of PRA authorised persons (therefore in line with the PRA's general objective) this does not mean the same thing and suggest that the safeguard is copied into the PRA's section.

Box 2.F: Consultation question

7 Do you have any views on the FCA's objectives – including its competition remit?

As noted in our previous submission, we support the formulation of clear statutory objectives and welcome the fact that the FCA's objectives are drafted as such and generally avoid the blandness of the PRA objectives that we have criticised above (see 2.D).

We think that, for the reasons given below, the proposed objectives need amendment to reflect:

- the FCA's role as the prudential regulator for the vast majority of authorised firms;
- the FCA's role as a markets regulator;
- that competition issues involve international as well as domestic considerations.

Given that the FCA will be the prudential regulator for the vast majority of authorised firms, it could be regarded as odd that it does not have an explicit operational objective reflecting that role. Pursuant to the June FSA paper, "The Financial Services Conduct Authority, Approach to Regulation", the integrity objective is concerned with the soundness and resilience of the trading infrastructure; the integrity of the financial markets, including the reliability of the price formation process and suitability of listing rules; combating market abuse; and addressing the extent to which the UK financial system may be used for the purposes of financial crime. These considerations do not address the FCA's responsibilities as the prudential regulator for a large number of regulated firms. We think that is an important aspect of the FCA's role, which seems to have been largely overlooked, and ought therefore to be reflected in an operational objective. As a general point, we note that there is still very little detail regarding the FCA's role as a prudential regulator, and the approach that it intends to adopt. This is a significant gap in the proposals to date.

Another critically important aspect of the FCA is its role as a markets regulator. Whilst, as noted above, we understand that the integrity objective encompasses some aspects of market infrastructure, as with the FCA's role as a prudential regulator, it appears that the FCA's role as a markets regulator has likewise suffered a lack of attention. It is essential that the FCA has a clear remit with respect to the regulation of markets, and that it has the appropriate resources to fulfil that function. We fear that, unless these roles are clearly addressed in legislation, the FCA will necessarily focus its resources, which are not infinite and need prioritisation, on other functions. There should be a differently focussed objective concerning the proper protection of the wholesale markets.

With respect to competition, we support the proposed approach whereby the FCA will have a duty to discharge its general functions in a way that promotes competition, insofar as this is compatible with its objectives. The competition aspects of the FCA appear to be domestically focused. Addressing the desirability of maintaining the competitive position of the United Kingdom in the international context is an argument for others to make. However we would have thought that it is important and, if the Government agrees, then the competition remit should extend to having regard to international considerations.

In this regard, we note that in its current form the Financial Services and Markets Act 2000 requires the FSA, in discharging its general functions, to have regard to a number of factors, including:

> "The international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom".[1]

Whilst the international character of financial services and markets has been recognised in the various consultation documents, and reference has been made to the growing importance of European institutions and legislation, this does not appear to have been carried across to the proposed legislation. In discharging its functions the FCA should have regard to the wider European supervisory and regulatory framework, and its role within that.

Regulatory Principles

As stated in our previous response we do not consider that the principle in section 3B (1) (e) (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, we do not think it is a "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 to be helpful either as a guide to the FCA or as a means of holding it to account.

We also consider that the principle in section 3B (1) (f) (that regulators should exercise their functions as transparently as possible") should be qualified by the requirement that this is subject to observing principles of natural justice and fair treatment of authorised firms.

Consumer protection objective - Definition of consumer

As has been noted, the definition of "consumer" is very wide. Notwithstanding the requirement for the FCA to have regard to the differing degrees of experience and expertise that different consumers may have, the broad definition of "consumer" in this objective creates potential downstream problems, as it captures anyone, including market counterparties. The consumer protection objective is clearly aimed predominantly at retail clients acting outside the course of their normal business, but given the wide definition of "consumer", a proportionate approach is then put forward as a means to temper the application of this objective to such other clients who would not traditionally be regarded as a consumer.

We think it would be much better to have an objective more appropriately focussed on the target retail/non-professional client population with a separate objective concerning the regulation of markets and market professionals.

If the current approach and wide definition is retained then, because the definition of "consumer" is far broader than is commonly used in other contexts, including European legislation, care will need to be taken to ensure that the use of the narrow definition of the word "consumer" in other contexts, does not result in legislation or regulation that is designed for that narrow construction, being applied to the broader definition of "consumer" currently proposed under the new legislation.

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1 Financial Services and Markets Act 2000 s2(3)(e).

Further, we note that the proposed Act has at least four different definitions of "consumer".[2] This will almost inevitably cause great confusion. Accordingly, we suggest that a different term be used, for example "clients and counterparties" in the objective (which could include potential clients and counterparties).

Box 2.G: Consultation question

7 Do you have any views on the proactive regulatory approach of the FCA?

As the Government is aware we raised serious concerns on the issues covered in this section in our previous response. We are more than disappointed that there has been no material change to the proposals.

The product intervention power

We continue to have concerns regarding the nature and scope of the product intervention regime. There is very little detail regarding the nature of a "product", or how this will be defined. We think that identifying the objectionable characteristics of a product will be critical in order to provide appropriate certainty. Additionally, we have concerns about how the product intervention rules will work in practice, and the impact that intervention will have on consumers and providers. The proposals give rise to questions around legal uncertainty, for example how such powers will impact existing contracts and the role, responsibilities and liabilities of different firms within the distribution chain.

With respect to the temporary product intervention powers we note that the FCA will be required to consult on and publish a statement of policy setting out the circumstances in which it may make temporary product intervention rules, and we agree that this is appropriate.

We assume that the product intervention rules will not apply to products being sold into the United Kingdom by an EU entity on a cross border services basis, given that FCA rules will not be applicable in that scenario. This creates an unlevel playing field. We therefore encourage the Government to consider the product intervention rules in the light of the powers that the European Securities and Markets Authority will have to ban certain products. This would remove concerns about regulatory arbitrage. At the least, it would seem sensible to defer the implementation of any UK specific rules until the scope of the European regime is clear. Alternatively, such rules should not apply to any products that can be sold under European Directives on a cross-border basis.

Retail customer limitation

Paragraph 2.97 states that the product intervention tool is to be used "in support of retail customers." We can see no such limitation in the proposed legislative changes. Linking the power to the consumer protection objective does not achieve this as "consumer" within the meaning of that objective covers anyone of any kind anywhere. The provision that a further instrument is required for the power to be used to support the integrity objective does not

[2] Section 1C(3), section 425A, section 425B, section 404E.

mean that the existing power cannot be used in relation to professional and wholesale customers.

We think that it is extremely important that the restriction on the use of the power is clear on the face of the legislation if the Government really intends to limit the potential use of the power.

Statement of policy

We do not understand why the statement of policy is to relate only to the making of temporary product intervention rules. We did not understand the previous consultation to suggest this. These are new and significant powers, and we believe that the FCA should be required to have a stated policy as to its approach to the use of the power generally.

We commented previously on the proposal, now reflected in the draft, that the legislation make provision for the unenforceability of contracts made in breach of product intervention rules. The draft does not indicate what if anything is intended in respect of products that are sold in advance of a banning order? We assume that any rules could not have retrospective effect on contracts and indeed consider it highly undesirable that they should do so, but we suggest that this should be clearly stated in the legislation.

New financial promotion powers

We note that paragraph 2.103 says that there was widespread support for this power. As the Government is aware we did not support it and expressed concerns about it. We noted that 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, the FCA could 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 FSA financial promotions unit currently adopts a number of approaches in relation to financial promotions which it considers may breach its rules. This gives it flexibility. Is it intended that in future all financial promotion concerns will be dealt with by the "directions" route? We would hope not but this is not at all clear.

We do not think that a direction should require the authorised person to publish details of the direction (137P(2)(c)). This seems wholly inappropriate given that subsection (11) requires the FCA to do so.

However we also have serious concerns about this mandatory publication, *"the FCA must publish such information about the direction as it considers appropriate (even if the direction is revoked)"*. What if the FCA considers that that publication is not appropriate? We understand the process to involve the giving of a direction, which may or may not then be amended or revoked after representations have been made by the authorised person. It is wholly wrong to require publication of a direction which the FCA decides, after hearing representations, should be revoked. The fact that it is revoked strongly suggests that it should never have been made, let alone publicised. Paragraph 2.105 says that publication "may include a fair summary of the firm's representations where it contests the FCA's direction". Since publication is mandatory we believe that this should also be mandatory.

The entire process, even though it involves an asserted breach of regulatory rules, lacks the checks and balances that apply under the Warning Notice procedure and is to our mind fundamentally unfair and is not necessary to protect consumers from misleading promotions.

We also note that firms could avoid this outcome by establishing a presence in other Member States and advertising cross-border.

Early publication of disciplinary action

We continue to believe that this is one of the most objectionable parts of the new legislation. We simply do not accept that it contributes to the strategy of credible deterrence, and, if it does, it does so in a way which disregards fundamental legal principles and principles of natural justice, including the presumption of innocence, the right to know the case against you and to have an opportunity to present your case. The provisions dangerously shift the burden of proof towards a guilty until proven innocent stance. It is therefore a disproportionate means of achieving the stated objective. We cannot see how it helps consumers to be made aware of untested allegations.

As we noted before, 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. Not every warning notice results in a Decision Notice; very many do not. 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. In addition, in our experience, even when a warning notice is followed by a Decision Notice, the content is often materially different.

Paragraph 2.109 states that the power will be subject to safeguards. We do not think the safeguards listed in paragraph 2.110 are adequate. Prior consultation with the person to whom the notice is given cannot be adequate unless at the same time that person is given access to the material on which the FCA relies. How can he make a sensible comment on a potentially damaging publication without the opportunity to point out that the FCA has misdirected itself or is missing vital information?

This is not an academic point. At present such material is not disclosed until after the Warning Notice procedure has completed. In the real life experience of the members of this Committee in dealing with FSA enforcement actions, the provision of this material has often enabled a person to point out that it does not have the meaning etc. attributed by the FSA or that the FSA is missing other important information which would change the character of what it has. It is by no means the case that a person already knows the material which is in the FSA's hands. Allowing, in effect, a regulator to shout untested allegations through a megaphone is not in our view likely to bring respect for the regulatory regime.

In any event, the key nature of this issue is such that the safeguards framework and key substantive safeguards are matters that should be set in primary and secondary legislation, not by the regulator.

We do not agree with those who suggest this is no different to a criminal case. First and foremost, these are not criminal matters. Moreover it is wholly inappropriate to compare the giving of a warning notice with the formal charging of a defendant in a criminal justice process. The latter marks the start of a process which is wholly conducted before an

independent and impartial tribunal, and is largely conducted in the public domain with restrictions on what may properly be reported by the media. As a consequence there is always an independent person controlling the process, the testing of the prosecution's assertions is done in the public gaze and by evidence on oath, and the result clear for all to see. None of that is true of the warning notice step. The process is controlled by the regulator, the testing of the regulator's case is done in private and there is no provision for it to be by evidence on oath (the process is one of making representations not of assessing evidence). There is no process for exposing to public view any shortcomings in the regulator's case – and should the representations be wholly successful there is no proposed mechanism to explain why the published warning notice was ultimately not maintained. Simply withdrawing it from further public gaze does nothing to address media coverage that has already occurred and it will remain forever available on the internet.

As the Government is clearly determined on this course there are five fundamental changes which we believe must be made. These are:

(i) the provisions should not apply to individuals (unless authorised as sole traders) as here the balance of fairness must clearly lie in favour of the individual. In addition our understanding is that the concern is to protect consumers in their dealings with authorised firms;

(ii) firms must receive the material on which the FCA relies before they receive the Warning Notice;

(iii) as mentioned above, there should be a statutory framework for safeguards with certain specific safeguards or principles enshrined in legislation;

(iv) firms should have at least three business days' notice of publication of a warning notice, subject to a right of the FCA to override this in accordance with the statutory framework suggested above (giving reasons for doing so); and

(v) firms must be able to make such statements as they feel appropriate and in this regard new section 391 (1) (b) should be amended.

Box 2.H: Consultation question

8 What are your views on the proposal to allow nominated parties to refer to the FCA issues that may be causing mass detriment?

The current regulatory framework does not prevent individuals and/or organisations/industry bodies/consumer organisations, including the FOS from raising issues with the FSA regarding potential mass consumer detriment. We assume that this proposal is not intended to discourage individuals or organisations from continuing to raise issues with the FCA, therefore, the benefits of introducing a formal reference procedure are not immediately obvious or clear to us.

There is a risk, however, that the FCA may be required to prioritise formal referrals over other types of referrals, which may lead to the FCA inappropriately diverting resources away from responding to valid concerns raised by other sources or worse still diminishing its ability

to meet other regulatory priorities due to capacity and resources issues. Thus if the Government is minded to introduce a specific statutory provision, we suggest that:

- the formal rights of referral should be limited to a narrow range of bodies which have functions under FSMA;
- the basis of the formal referrals are clearly defined; and
- the steps, if any, the FCA is obliged to take realistically reflect the resources that are available, and its capacity to act within any proposed deadlines. We assume that the FCA would only be obliged to respond to issues that are important to its statutory objectives.

Box 2.H: Consultation question

9 What are your views on the proposal to require the FCA to set out its decision on whether a particular issue or product may be causing mass detriment and preferred course of action, and in the case of referrals from nominated parties, to do so within a set period of time?

The Government will need to ensure that any decision reached by the FCA does not:

- force it to prejudge either individual cases where it wishes to take disciplinary action or prevent it from acting properly in relation to such cases;
- prevent it from carrying out proper consultation on any proposed new rules or guidance;
- prevent it from taking account of evidence (for or against mass detriment) arising at a later date.

Given the complexity of the issues that the FCA may have to consider following a referral from a nominated party, we do not consider that it would be appropriate to impose any mandatory timescales for responses/decision. Further, the imposition of deadlines for responses will likely exacerbate the resource issues raised in our response to question 8 above. If the Government is minded to introduce "deadlines" for FCA responses then we suggest that the deadlines should take the form of a "guideline" rather than a mandatory requirement.

Box 2.I: Consultation question

10 Do you have any comments on the competition proposals for the FCA?

We note the proposals for a "two tier" approach to OFT intervention concerning anti-competitive situations in the markets supervised by the PRA and the FCA.

We consider that where the second tier is in issue, the backstop Treasury power of direction set out in section 140H should not only be subject to the Treasury having considered the

original section 140B advice from the OFT and the response of the relevant regulator to that section 140B advice, but also to the Treasury having consulted with, or at least provided an opportunity for additional representations to be made by, both the FPC and the PRA (and we suggest this should be regardless of whether the original section 140B advice was given to just one of those two regulatory authorities).

To give an example of why this should be the case: it may fairly be assumed that if the PRA or FCA has declined to take action in response to section 140B advice, it is because it regards the action recommended in that advice to be potentially harmful to its own regulatory objectives. It may be, for example, that a competition remedy which the PRA considered was at risk of impacting disproportionately negatively on, for example, the stability of certain firms in the deposit-taking sector could also have a relevant impact on confidence in the UK financial system in the view of the FCA (notwithstanding that the FCA was not the subject of the section 140B advice).

In such a case we agree it should be for the Treasury to balance the competing objectives of the competition authorities and the PRA/FCA, but in so doing it must be appropriate, and ultimately beneficial, for the Treasury to be required to take account of all relevant views of all relevant authorities in each such case.

Box 2.J: Consultation question

11 Do you have any views on the proposals for markets regulation by the FCA?

The FCA's power to suspend or limit the activities of a sponsor as provided for in section 88E (powers which are activated if the FCA considers that it is desirable to take action "to advance one or more of its operational objectives") assumes, when viewed alongside the power provided for in section 88A (which are activated if a sponsor contravenes a requirement or restriction), that the sponsor does not need to have breached any rule, requirement or restriction. Rather Section 88E appears to give the FCA a broad discretion to intervene in otherwise legitimate sponsor activity and the grounds on which it may do so are unhelpfully and unfairly opaque.

We regard the provision at new section 97A for requiring a skilled person report in respect of issuers as being wholly unwarranted. Issuers are not in the same relationship to the FSA as authorised investment businesses, whose whole business comes within the scope of regulation and whose ordinary business activities may need to be investigated. Issuers that seek a listing accept that they thereby become subject to a set of rules and obligations and must stand ready to be investigated if they fail to comply (and suffer the consequences if they are found wanting) but they should not, as a matter of principle, be subject to sanctions (which is what the obligation to pay for a skilled person's report amounts to) in the absence of, at the very least, a reasonable suspicion of wrongdoing. In addition to this objection of principle there is a serious risk that the UK will be perceived to be a less desirable place than other competing European financial centres as a place for listing. Moreover it is another provision which in practice is likely to operate more harshly on domestic firms as it is difficult to see how this power would be exercised in relation to an overseas issuer with no UK presence (the only remedy for non-cooperation may be to de-list); yet a differentiated approach in practice for UK and non-UK issuers seems undesirable.

Box 2.K: Consultation question

12 Do you have any comments on the governance, accountability and transparency arrangements proposed for the FCA?

We have particular concerns about the provisions for "regulatory failure" investigations (section 51 of the draft Financial Services Bill in case of the FCA, rather than section 46 as stated in paragraph 2.131 of the White Paper).

Our concerns relate to what the White Paper refers to as the "triggers" for the duty to investigate and report to arise. Some of the provisions are not sufficiently specific; other provisions risk creating 'hair triggers', likely giving rise to unintended practical administrative consequences.

Consumer detriment effect – a hair trigger?

Our concerns in relation to the consumer detriment trigger at section 51(1)(a)(i) of the draft Bill are equally relevant, albeit perhaps to a slightly lesser degree, to the financial integrity trigger at sub-paragraph (ii), and for the same reasons.

In view of the breadth of section 51, which applies not only to perceived shortcomings in the regulated community, but also to the detrimental activities of unregulated persons (such as boiler rooms and land-banking operators), the constituency of potential candidates for a <u>mandatory</u> investigation is substantial.

If one were to apply section 51 retrospectively to the events of recent financial history, there would likely be an enormous number of regulatory failure investigations generated by, for example:

- every instance of systemic mis-selling (which by implication identifies a failure to secure an appropriate degree of protection for consumers), and
- every significant rogue scheme operating beyond the FSA's regulatory perimeter,

because in each case it would be arguable that the FSA had failed to enforce its rules or Principles or had failed in its role as perimeter policeman.

It is to be questioned whether there should be an <u>automatic</u> duty to enquire and report in all such cases. There are two immediately obvious and adverse consequences:

- the FCA would risk being overwhelmed, and
- a regular stream of investigations and self-criticism would both lessen the impact of each report, and weaken confidence in the regulator and the UK financial system, and thus rapidly defeat the object of the provisions.

We also observe that it is not intended that the FCA deliver zero-failure supervision, thus implying that a certain degree of regulatory failure must be tolerated; does the Government intend to require the FCA to be <u>required</u> to explain itself in public each time there is a failure (other than insignificant failures)?

We consider that section 51 is thus at risk of being too rigid in its application, and that its scope is presently too wide and uncertain.

Regulatory failure in relation to the 'efficiency and choice' and 'competition' operational objectives

We query whether it is appropriate to tie regulatory failure triggers to either of these two objectives:

- judging an "adverse effect on the efficiency and choice in the market for....services" seems much too vague a process to found a mandatory duty. Further, it must be questionable that an "efficiency and choice" effect could ever be of the same order of magnitude (as regards the financial health of the UK or of individuals) to warrant the same mandatory procedure as a failure in respect of the consumer protection or integrity objectives. If this trigger provision is to be retained at all, we suggest it be recast as a power to investigate rather than a duty (probably subject to a Treasury backstop power of direction); and

- it seems wholly inappropriate for the trigger to be capable of being pulled by the FCA making a competition judgement when the Government has expressly decided not to give the FCA either fully or partially concurrent competition powers. If an adverse impact on competition is to be retained as a reporting trigger, an alternative option would be for the Treasury to pull that trigger after having received representations from the relevant competition authorities.

Engagement with regulators

We note the comments in paragraph 2.129 of the White Paper concerning FCA transparency and the decision not to legislate for the matters there mentioned which were canvassed for by some respondents to previous consultations.

We are concerned that the FCA may be implicitly encouraged by the Government to continue what is in our view an unfortunate tendency of the FSA to make or announce policy in non-official terms and circumstances (such as through speeches or in 'non-guidance' posted on the FSA website) but then nevertheless to hold firms and individuals to account as if formal rules or guidance had been made.

We suggest that the FCA should be scrupulous about following the proper procedures for developing and making known the standards it expects of firms and individuals. We hope that the Government will endorse this view.

Box 2.L: Consultation question
13 Do you have any comments on the general coordination arrangements for the PRA and FCA?

Operational delivery of effective coordination

We reiterate our comments made in response to February consultation, where we strongly urged the Government to consider a "shared services" function to act as a common back office for the PRA and the FCA in respect of regulatory processes. This is to minimise duplication on firms. We note that the Bank of England and the FSA will be publishing a document later this year setting out more fully the plans to deliver operational coordination, on which we expect to provide further comments. However, this is not enough. A shared services function and co-ordination of certain operations should be required; the Act should empower the Treasury to make orders on this.

We support the Government's proposal to impose on the regulators a statutory duty to coordinate, and in particular the inclusion of references to the need to use the resources of each regulator in the most efficient and economic way, and the principle that a burden or restriction which is imposed on a person or the carrying on of an activity should be proportionate to the benefits. However, the duty to coordinate provided for in new section 3D FSMA states that each regulator is required to consult the other regulator where the exercise of its function may result in "material adverse effect" of advancement by the other regulator of its objectives. Is this intended to denote a subjective or objective standard? More clarity over the circumstances in which regulators would be expected to coordinate on a day to day basis is required. This also seems to set the bar at which consultation is required at quite a high level (the requirement is only triggered when a potential material adverse effect to the advancement of the other regulator's objectives is perceived). We continue to have concerns that a lack of clarity and transparency over circumstances in which the duty to coordinate applies will leave the dual-regulated community in a position of uncertainty.

Memorandum of Understanding

Whilst we are of the view that the indicative list of issues to be included in the MOU between the FCA and PRA is reasonably comprehensive, we are concerned that because there is no requirement to publish in the MOU any "technical or operational matter not affecting the public", this will give the authorities licence not to include much of the operational detail that is of interest to dual-regulated firms, if not to the public at large. We are not therefore convinced that the regulators should be given the ability under section 3E(8)(b) to omit from the memorandum material relating to aspects of compliance with their co-ordination duty where such aspect "is a technical or operational matter not affecting the public". The regulators would have the ability under section 3E(8)(a) to omit information which they consider not to be in the public interest. Any other information should be addressed in the memorandum. Section 3E(1) provides that the information must relate to the performance by the regulators of their qualifying functions. Accordingly, the presumption should be that material relating to these functions should be included in the memorandum or, if not appropriate to include in the memorandum, published in some other manner. Further, we struggle to identify those aspects of the co-ordination by the regulators of the performance of their qualifying functions which do not affect the public. The grounds on which exceptions to transparent conduct by the regulators are made should be strictly limited, for example where the co-ordination or performance relates to a particular person or case.

It is not clear why the regulators are permitted but not required to include in the memorandum provided for in section 3E of the Draft Bill, material on the subjects listed in section 3E(2). The regulators are required to include material on the subjects listed in section 3E(3) and we can see no good reason why that same obligation should not also include the subjects in section 3E(2). The regulators would still be entitled by section 3E(8) to omit material on public interest grounds in respect of the subjects in section 3E(2).

We support the requirement in FSMA that the PRA and FCA include in their annual reports an account of how they co-ordinated throughout the year, but Treasury should have the power to impose minimum requirements in case such accounts are too bland.

Is the PRA's power to veto the FCA's proposed use of any of its powers limited and transparent enough as to the circumstances in which it could be used? We support the requirement for the PRA to consult the FCA before exercising its right of veto. Although PRA is required to give a copy of the notice to Treasury, which in turn must lay it before Parliament, there is no indication as to whether this must be done before or after the power has been exercised. This should be clarified. The circumstances in which the PRA may exercise its power is still vague in the draft legislation – e.g. it is exercisable where the use of the FCA's power may (a) threaten financial stability or (b) result in the failure of a PRA-authorised firm in a way that would adversely affect the UK financial system. Market participants still therefore lack a clear picture of circumstances in which the veto can and is likely to be exercised. There is clearly scope for disagreement between the PRA and the FCA over the exercise of the veto, and the legislation adds to the perception of the PRA as the more senior regulator.

Paragraph 2.149 indicates that the PRA's right of veto under section 3H of the Draft Bill could not be used "to prevent the FCA from doing something that it is legally required to do". However, section 3H(7) refers only to EU and other international obligations. Accordingly, it is likely that the correct interpretation of section 3H is that the veto could be used to prevent the FCA from performing a legal obligation which is not an EU or international obligation. If the intention is as stated in paragraph 2.149, the text in section 3H(7) would require amendment. If enacted in its current form, the veto right in section 3H is likely to permit the PRA to exercise its veto with the result that the FCA may find itself in breach of an obligation under domestic legislation. If this is the intention, the guidance in paragraph 2.149 should be corrected.

Box 2.M: Consultation question

14 Do you have any views on the detail of specific regulatory processes involving the PRA and FCA?

Authorisation

We support the Government's decision in opting for the "alternative" authorisation process whereby for dual regulated firms the PRA as the authority with responsibility for prudential regulation of an applicant, will manage the application process overall, and will grant permission (although the FCA's consent will be required). However, we remain of the view that the FCA is the appropriate regulator to lead on applications for dual-regulated firms, since this would facilitate the development of a centre of authorisation excellence within a single regulator.

Alternatively, this is a process well suited for the shared services function for which we and others have pressed (see our response to 2.L).

The Government, in the case of dual-regulated firms, still intends to give the authorities powers to designate sole or lead jurisdiction under the threshold conditions, yet the process provided for in the draft legislation is unclear as to specifically how designation will take

place, and what would happen if the authorities cannot agree. It is crucial for market participants to understand how these arrangements will work, and further clarity is required.

We reiterate our comments concerning the need for firms to be given clear expectations of the time limits for processing authorisation applications and the service standards that will be applied. It is important that the time taken to review an application does not exceed the current statutory time limits and service standards applicable to the FSA. 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.

Box 2.N: Consultation question

15 Do you have any comments on the proposals for the FSCS and FOS?

We welcome the recognition in the White Paper that EU developments on compensation schemes may have a considerable impact on this aspect of regulation. We agree that, pending those developments, the existing approach on the UK's compensation scheme (which has been the subject of recent review itself) should be retained.

In relation to the position of the FOS, we consider that the White Paper still misses a key point. As we pointed out in our April response to the previous consultation, the FOS' dispute resolution mechanism should not mean a process with unpredictable outcomes, or outcomes that have no sound basis. In practice the FOS has taken on the character of a secondary regulator, whose awards take on an unwarranted role as precedent, and are used to justify the imposition of a retrospective review and compensation process across a significant part of a firm's business. This can result in retrospective imposition of different standards from those understood at the time of the original business – something the FCA would not properly be permitted to do using its powers. The FOS' role should be constrained so that it has no power to make an award when a firm has acted in compliance with the applicable regulatory and legal obligations. As a result we consider that the FOS should be obliged to apply the law in all cases. "Swift and impartial" should not mean "irrespective of legal obligation".

The transparency proposals in the draft legislation further emphasise the need for the FOS' decision making to be constrained in this way. Publication of awards will increase further the likelihood that they will (in the eyes of the FOS and consumers – and potentially the FCA) raise expectations that they are to be followed.

In our April response, we expressed concern about the FOS having a completely free discretion on publication of decisions. We do not consider that the publication proposals in the draft legislation are an improvement in ensuring fairness to firms about which complaints are made. It is difficult to see any fairness in a process that contemplates that the person initiating a complaint can insist on anonymity (irrespective of the merits of his complaint) whereas a person with no option but to cooperate in the process, and no certainty that the contemporaneous regulatory requirements will be used as the standard for assessing the merits, cannot do so. Indeed on the face of the proposed legislation, a person who makes a completely unfounded complaint (and who is someone who might in other contexts be regarded as vexatious) can insist on anonymity, yet a firm subjected to what is ultimately

found to be a frivolous complaint must be named. In addition, naming a firm as having breached a regulatory obligation in a FOS award is the same, in kind, as a public censure against the firm. If such a censure was to be imposed by the FCA or the PRA, there would be far greater safeguards of fair hearing than exist for the FOS. This highlights a theme which appears more than once in the draft and in Government policy, namely mechanisms are being introduced which completely undermine the protection offered by other parts of the Act which were designed to ensure fair process.

The FOS currently publishes summaries of example awards (both upheld and not) in its "Ombudsman News". These are summaries of the issues, approach and outcomes on an anonymised basis intended to assist firms and other users of the FOS. If there is merit in publishing FOS award outcomes to a greater extent than at present, to assist users of the FOS, there seems to us to be no justification in going further than the approach currently taken (i.e. anonymised and summary).

Variation and removal of permissions

We support the Government's proposals regarding the requirements for the PRA and FCA to consult with each other prior to exercising OIVoP powers in a way that could affect each other, and for the statutory MOU to set out further information about the use of OIVoP.

Approved persons

We support the Government's alternative proposal regarding the approved persons regime whereby the PRA would have primary responsibility for designating SIFs, but where the FCA may designate SIFs where the PRA has not done so. The authorities would be required to consult each other to minimise the risk that the codes they make overlap or duplicate.

However, we are still of the view that this “twin track” application process is potentially cumbersome, and duplicative, and a system where one regulator had overall responsibility for the whole application would be more sensible. Considerable co-operation between the FCA and the PRA will be required on how the approved persons regime will operate in practice, including which of the controlled functions concern the FCA and the PRA. In particular, we reiterate our comments made in relation to the previous consultation regarding the necessity of ensuring that timeframes for processing approved persons applications do not increase, and that applicants for SIF functions which concern both the PRA and the FCA and require an interview are subject to only one interview attended by representatives from both authorities.

Passporting

We reiterate our concerns with the proposed process for outward passporting firms, whereby the process for dual-regulated firms wishing to establish branches in other EEA Member States under a passport is that the PRA is responsible for issues relating to financial soundness, and the FCA is responsible for all conduct issues. In particular, we are concerned that there is to be no discussion concerning how this separation of responsibility would occur in practice.

We have some concerns with the Government's proposals regarding the PRA receiving notifications from overseas regulators concerning some EU directives, with notifications in respect of other directives going to the FCA. Whilst we understand this will be provided for in

secondary legislation, there will need to be a clear framework within the secondary legislation for communication between the FCA and the PRA of notices received.

Rule making

We reiterate our concerns about the potential implications of the division of the FSA current integrated FSA Handbook, and whilst we support the Government's proposals requiring the regulators to consult with one another before making rules, we remain of the view that two sets of rules covering the same content is at the very least unnecessary and burdensome to firms who need to analyse their obligations under both sets of rules. This seems unnecessary considering the increasing amount of regulation coming out of Europe, and the fact that much of this regulation now takes the form of Regulation, which has direct effect in Member States and does not need to be implemented via domestic legislation. We would also urge that the regulators' duty to consult one another before making rules applying to the same functions should also apply to any guidance (whether formal or informal), or statements of purpose (in the case of the PRA) relating to these rules.

Group supervision

We welcome the Government's proposals that it will expect coordination and cooperation between the two authorities as the main means of achieving effective and efficient group supervision, and we look forward to seeing the draft MOU between the PRA and the FCA.

Unregulated holding companies

We welcome the safeguards that the Government is proposing to place on the proposed power of direction over unregulated parent undertakings which control and exert influence over authorised firms. In particular, we welcome the statement by the Government that the power should only be used by the regulators on "relatively rare occasions" and that the trigger for the use of the power has been set at a higher level than proposed in the February consultation (e.g. where the regulator considers that the acts of the parent undertaking are having a material adverse effect on the regulation of authorised persons in pursuance of its objectives).

We support the proposal by the Government that before exercising the power of direction, the regulator must consider the effectiveness of its powers in relation to any of the authorised persons in the group, not solely the direct subsidiaries of the 'target' parent. We think it is important that the power is exercisable only when all other available regulatory tools have been exhausted in relation to the relevant authorised firms and that this is clear on the face of the legislation.

Change of control

We reiterate our comments made in relation to the proposals in the February consultation that we are of the view that it is desirable for all change of control applications to go to a single regulator, and we remain concerned by the proposals to require applications for change of control involving a group that includes dual-regulated firms and firms that are prudentially regulated on a solo basis by the FCA to be submitted to both the FCA and the PRA.

This debate (and the issues arising under other heads, particularly in respect of variations of permission, approved persons, and passporting as addressed under the headings above in

this response to 2.N) again emphasises the need for a shared services function or single approach to be presented on a range of process issues.

Registers

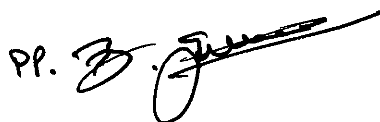
Another area where a shared service should be required is the maintenance of a single register of authorised persons, approved persons, recognised bodies, etc. (all accessible through one internet address as at present), rather than leaving this issue to the regulators to agree.

Part VII transfers

We reiterate our comments made in relation to the proposals in the February consultation, and in particular that we doubt the sense of the PRA leading on all Part VII transfers, particularly a Part VII transfer of life business involving with-profits business, where matters relating to Treating Customers Fairly are key, including in communications to policyholders.

If you wish to discuss our comments, you may contact me on +44 (0)20 7295 3233 or by email at margaret.chamberlain@traverssmith.com.

Yours faithfully



Margaret Chamberlain
Chair, CLLS Regulatory Law Committee

THE CITY OF LONDON LAW SOCIETY
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CBI
THE VOICE OF BUSINESS

Response September 2011

A new approach to financial regulation: the blueprint for reform

CBI Response

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The UK's new regulatory architecture will help support a robust financial system. But further work needs to be done on a number of fundamental issues if the framework is to be fit for purpose

The CBI represents firms from across the regulated and unregulated financial sector – including universal and investment banks, insurance firms, investment firms and consumer lenders. We also represent the users of financial services as the UK's premier business organisation.

Summary

This document responds to HM Treasury's 'A new approach to financial regulation: the blueprint for reform'. It raises issues that our members have identified and suggests ways in which we believe the legislation could potentially be improved.

The changes to the domestic regulatory framework will take place amidst far-reaching changes to the regulation of the financial services sector - from capital adequacy and liquidity reform and recovery and resolution regimes through to proposed financial market reforms and proposals by the Independent Commission on Banking - all of which contribute to a regulatory environment which is rapidly changing but overall looks promising in its ability to manage future crises.

We support the main elements of the draft legislation, but we believe there are improvements that need to be made to ensure that the UK financial services sector can continue to support businesses and contribute to the UK economy in the coming years without running the risk of financial instability, failures of market conduct or mis-selling.

Our response takes the following structure:

1. Objectives, Principles and Scope
2. Governance and Accountability
3. Powers and Regulatory Approach
4. Co-ordination

Appendices A and B set out how these relate to the specific questions asked in the paper.

1. Objectives, Principles and Scope

Establishing the right foundations of the regulatory architecture is essential as the objectives and principles that it is set now will determine its judgements over the longer term.

This section sets out the CBI's position in respect of:

- *The FPC's objectives*
  - *The growth objective*
  - *The competitive objective*
- *The PRA and FCA's competitiveness objective*
- *The PRA's insurance objective*
- *The FCA's competition duty*
- *The Principles of Regulation*
  - *Transparency*
  - *Transparency of the regulator*
  - *Consumer responsibility*
  - *Competition*
  - *Competitiveness*
- *Consumer credit*
- *Claims management companies*
- *Definitions*
  - *Financial stability*
  - *Consumer*

The FPC's objectives

We are generally supportive of the FPC's objectives but believe that it should have a proactive focus on supporting economic growth. It is also important that the regulators consider the competitiveness of the UK financial services industry…

Growth objective

The FPC's macro-prudential powers are designed to support financial stability but they may, by their nature, also have an impact of economic growth.

The current text of the FPC's objective is designed to constrain the FPC from acting in a way which is likely to severely damage the economy in the medium or long term. HMT has stated that they believe that this provides for an appropriate interaction between financial stability and economic growth in the FPC's objective.

We disagree. We believe that the committee should have a more proactive focus on growth.

Although we welcome the recognition of the need for the wider growth and condition of the economy to be taken into account when setting FPC policy, the Committee should also focus on the active promotion of growth.

This would not conflict with the FPC's main objective because medium and long term economic growth is consistent with financial stability. It would be consistent with, for example, the objective of the European Systemic Risk Board ("ESRB") which requires the body to '*contribute to the smooth functioning of the internal market and thereby ensure a sustainable contribution of the financial sector to economic 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".*

Alternatively, a secondary objective could be established which reflected the Monetary Policy Committee's ("MPC") secondary objective which requires it to support "the economic policy of Her Majesty's Government, including its objectives for growth and employment", subject to achieving its primary aim of maintaining price stability.

Competitiveness objective

We also believe that there should be a competitiveness objective to which the FPC should 'have regard'. 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. It is therefore important that the regulatory bodies and FPC consider the competitiveness of the UK when taking regulatory decisions, although it should, of course, be secondary to the need for strong macro-prudential, micro-prudential and conduct of business regulation.

PRA and FCA's objectives - Competitiveness

We believe the need to maintain the competitiveness of the UK financial sector should be reflected in the objectives of the regulators…

We are disappointed that the objectives that are proposed currently 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.

It is therefore important that the regulatory bodies consider the competitiveness of the UK when taking regulatory decisions, although it should, of course, be secondary to the need for strong macro-prudential, micro-prudential and conduct of business regulation.

The competitiveness of the UK financial sector and of UK business more generally should be a regulatory objective for the PRA and FCA and an objective to which the FPC should 'have regard'. This would be consistent with the objectives of a number of other overseas regulatory bodies, some of which have the objectives of 'ensuring' their financial sector's competitiveness.

If, however, the Government does not agree that it should be included as a regulatory objective in its own right, it must instead be included as a regulatory principle for the FCA and PRA. This will encourage the regulators to act in a way that is consistent with placing UK firms 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 regulatory principle that should be introduced could be phrased 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'.

PRA's insurance objective

It is vital that the regulators have experience across the entire spectrum of the financial services sector…

We are pleased the Government has recognised that the distinct nature of the insurance business ought to be reflected in the regulatory framework, and welcome that this will be included in the PRA's revised objectives.

However, we believe that more work needs to be done to ensure that the objectives coordinate and are compatible with the European regulations that the PRA will have to enforce, particularly relating to the objectives of Solvency 2 that set policy holder protection as an explicit objective.

We also believe that further clarity is also needed on how the inclusion of the statement that '*those who…may become policy holders*' in the objective will apply in practice.

FCA competition duty

The FCA's duty to promote competition is welcome, but its objectives do not mean that it should become a price or economic regulator…

The government has proposed that the FCA should be given the duty 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 additional powers.

We support the elevation of competition to being part of the general duties of the FCA. Competition can be used as an effective tool to improve consumer outcomes, particularly where issues arise across market sectors rather than at individual firms, although there are some areas where the competition objective could in fact reduce the stability of the financial sector, for example when dealing with market infrastructure.

The Government should also be explicit that the focus on competition to achieve regulatory outcomes does not mean that the FCA should consider competition in respect of issues outside its overall objectives. The competition objective should clearly constrain the FCA from, for example, interpreting its consumer protection operational objectives in a way that leads it to attempt to regulate prices or become an economic regulator.

The FCA should be careful when considering taking action in respect of excessive charges. We do not believe that this would align with its objectives in most cases, and it runs the risk of constraining the market and competition.

Principles of Regulation

The Principles of Regulation will steer the day-to-day focus of the regulators. They should be amended to avoid unintended consequences…

Transparency

The Transparency Principle is intended to promote a greater level of openness and disclosure by the regulators. We agree that in some limited cases publishing information relating to firms can help customers and help the regulators to achieve their objectives.

However, the principle should not be interpreted as meaning that there is a presumption that the regulator would publish confidential information just because it was relevant to a particular regulatory action.

Given the confidential, personal and market sensitive nature of much of the information that this may apply to, there should be a presumption of non-disclosure unless clear and precise reasons can be given for disclosing such information.

We therefore believe the transparency principle should be rephrased as follows:

'the principle that each regulator may make information relating to authorised persons or recognised investment exchanges available to the public, or require authorised persons to publish information if it believes that it is essential to the fulfilment of its strategic and operational objectives and giving due consideration to its status as confidential, personal or commercially sensitive information.'

Transparency of the regulator

We support the Principle that transparency of the regulators is an important part of their accountability, particularly to the firms they supervise. This is especially the case when seeking to understand recent judgements passed down by the regulators.

We look forward to the FCA's future publications setting out how it intends to meet its transparency

obligations in practice, and suggest the PRA follow adopt a similar approach.

Consumer Responsibility

We welcome the Principle of Regulation that consumers should take responsibility for their decisions. This is an important concept but, of course, it needs to be implemented effectively in practice.

The FCA has indicated in its 'Approach to Regulation' document that it will do more than the FSA has done to engage directly with retail consumers and to explain what they can expect from a regulated firm and from the FCA itself.

Although this is in itself welcome, we do not believe that it on its own will meet the demands of the Principle and the regulation. The regulators need to do more to explain to consumers what their responsibilities are and it needs to consider the principle when taking regulatory decisions and developing conduct of business policy.

Competition

See section on competition objective.

Competitiveness

See section on competitiveness objective.

Consumer credit and scope under the new regime

The possibility that consumer credit will be brought into the regulatory framework should be not be ignored as the regulatory framework approach is developed further…

It has been proposed that consumer credit is brought within the financial regulatory framework, although it is at an early stage of consultation. This proposal has advantages and disadvantages but if it is to proceed, it is important that the regulatory architecture and approach is appropriate for the large number and wide range of consumer credit firms.

Although these firms would have a framework of rules that had been designed for them specifically, broader elements of the regulatory framework that is currently the subject of consultation may be extended to them, for example regulatory objectives, principles and powers. If this is to be the case, the appropriateness of the framework for consumer credit firms should be considered at an early stage.

Claims management companies

Claims management companies that deal with financial services issues should be regulated…

Claims management companies ("CMCs") frequently target the clients of financial services companies. Often they focus on areas where there have been failures in the financial sector, targeting customers who may have valid claims on regulated firms and they sometimes provide customers with recommendations which relate to financial products. However they rarely give good value.

If CMCs are to be active in relation to financial products we believe that they should be brought within the regulatory perimeter. There is otherwise a risk that they recommend that their clients take certain actions in relation to the regulated products that they own, for example redeeming a bond or insurance product. This could result in client detriment.

Definitions

Precisely defining a number of the concepts mentioned in the legislation will aid in identifying the regulators' remits and objectives…

The Definition of Financial Stability

Financial Stability is a concept that is referred to frequently in the context of the regulatory architecture - the Bank of England has a Financial Stability Objective (see below) and it appears in the Prudential Regulation Authority's (PRA) objectives. However, financial stability is not itself clearly defined in the legislation.

An explicit definition of Financial Stability should be determined. This would bring clarity to the FPC and PRA's objectives and their potential trade off with economic growth but also to enable greater accountability of the Committee in meeting those objectives. The FPC has no equivalent to the MPC's inflation target so a definition of Financial Stability would help to increase the openness and transparency of the Committee, and may well prove useful in ensuring that the macro-prudential side of the Bank is as accountable as its monetary side.

A clear definition is also necessary so that it can be relied upon in the context of the other elements of the legislation and practical regulatory arrangements that refer to it.

The Bank of England's Financial Stability Objective is to:
'contribute to protecting and enhancing the stability of the financial systems of the United Kingdom'.

The Definition of Consumer

The proposed definition of consumer is wide and ranges from retail customers through to sophisticated wholesale investors. Various pieces of UK and European conduct of business regulations have individual definitions of client and ways of scaling the levels of protection afforded to different types of and sizes of customer.

Although a broad definition of consumer can be appropriate, we believe that it should be defined formally and carefully in such a way that builds in an automatic presumption of proportionality depending on the size and nature of the counterparty with which the firm has a relationship and the nature of the product or services being provided to them.

2. Governance and Accountability

The governance and accountability arrangements in and between the various regulatory bodies are crucial to ensuring that the bodies are effective and that their decisions are taken in a way that supports the objectives and purpose for which the regulators were established.

We have a number of concerns relating to the governance of the new regulatory framework and the accountability of the regulatory entities.

This section sets out the CBI's position in respect of:

- *Governance*
    - *Structure*
    - *Membership*
    - *Interaction between the FPC and MPC*
- *Accountability*
    - *FPC*
    - *PRA and FCA*
- *The Practitioner Panel*

Governance

The governance arrangements of the regulators need to focus on securing a cross-sector level of expertise within the setup of each regulatory body, whilst ensuring that effective co-ordination takes places without conflicts of interest …

Structure

Although the Bank of England and the regulators clearly face different risks to corporates, there are a number of principles of good corporate governance practice that are relevant to the proposed structure. The box on the following page sets out a number that have particular relevance.

We believe that elements of the bodies' governance arrangements diverge from general good practice. There are cases where conflicts might arise where committees and Boards which have significant overlapping membership have powers of direction over each other. There are also potential situations that can arise where individuals have to follow potentially conflicting objectives in different roles or exercise judgements outside of the formal decision making process.

The Government should conduct an independent review of the proposed governance arrangements and their appropriateness, so that all stakeholders can be assured that these new regulatory bodies are structured in a way that is effective and accountable and free from conflicts.

Membership

Although the draft legislation sets out the FPC's membership criteria it does not set requirements on the breadth of expertise that is needed.

It is clear that without, for example, practical insurance experience, there is a risk that issues that arose in the insurance sector could be missed or misinterpreted. Although we are pleased that the Government has recognised that the insurance expertise represented on the interim FPC and the PRA board is limited, this has not been addressed subsequently in the draft legislation. The legislation does not contain detailed provision

relating to the expertise required of non-executive members or FPC members.

We recommend the addition of a statutory requirement that the overall experience of the regulators' boards and the FPC should reflect the sectoral composition of the UK financial sector as a whole.

Key principles of corporate governance that are relevant to the regulators:

- The board and its committees should have the appropriate balance of skill, experience, independence and knowledge to enable them to discharge their respective duties and responsibilities effectively.
- There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision.
- Conflicts of interest can arise where individuals hold more than one position in an organisation or which have different objectives.
- The board should include an appropriate combination of executive and non-executive directors (and, in particular, independent non-executive directors) such that no individual or small group of individuals can dominate the board's decision taking.
- The board should identify each non-executive director it considers to be independent and state their reasons for that assessment.
- At least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent.

Interaction between macro-prudential and monetary policy

The FPC and the MPC have a number of common members and both are ultimately accountable to the chancellor. However, we believe that each should operate solely within the mandate that it has been set individually.

If the governance of the regulatory bodies works effectively then the public reports that they both will make should ensure that they are scrutinized against their individual objectives and targets. But this can only be assured if the overall regulatory governance framework is - and is seen to be - effective in promoting independence.

If Government believes that there is benefit to be had from closer coordination between the committees, a clear case for this should be made and it should be formalised in the committees' objectives and terms of reference.

Accountability

The regulators should be sufficiently accountable for the 'reasonableness' of their actions to Government and Parliament but also to those they seek to regulate…

Financial Policy Committee

We welcome the requirement for the FPC to publish Financial Stability Reports and meeting records and to present its report to the Chancellor.

However, given the nature, importance and timescale over which the FPC's decisions will take effect, the Committee must be in a position where it can be directly challenged and held to account for its decisions by Parliament. In particular, we believe that the objectives of the FPC and the regulators should be framed in a way that permits Parliament and Government to consider and hold the bodies accountable for the 'reasonableness' of their actions, given the information they had when the actions were taken.

FCA and PRA

We support the proposals for accountability of the FCA and PRA that are set out in the White Paper but believe that the regulators should also be accountable to the firms that they regulate. In particular, a stronger mechanism should be put in place by which regulated firms can challenge the decisions and approach of the regulators and hold them to account for the decisions they have made, particularly where the use of regulatory powers has had a significant negative impact on firms or consumers.

In order that the regulators can be challenged, it is important to set a clear standard against which they can be judged. We believe that this standard, and the legislation that underpins them, should be again based on a test of ‘reasonableness’. This would mean that the regulators would need to defend their actions in respect of individual firms or consumers on the basis that their decision was reasonable, given the information they had access to and the rules that were in place at the time.

This could be a test applied by the Upper Tribunal. Moreover, we believe that the remit of the Upper Tribunal should allow it to pass directions to the FCA, rather than just ask it to reconsider issues.

We also believe that the PRA should be required to hold an annual public meeting in the same way that the FCA does.

The Practitioner Panel

Consultation with the industry is a fundamental part of developing new rules and the regulators’ day-to-day supervision…

The Government proposes that the PRA should have some flexibility in deciding what kind of arrangements it wants to establish for engaging with industry. While the Bill places the PRA under a statutory duty to put in place arrangements for engaging with practitioners, it does not specify in detail what those arrangements must be.

Although we understand the Government’s desire to give the PRA operational flexibility, putting the panel on a statutory basis would provide a surer commitment to making sure that a wide range of relevant, practical industry experience is included.

3. Powers and Regulatory Approach

The new legislation will give the new regulatory bodies a range of new powers and tools. Some of these tools are new to the UK and internationally and regulators will need to use them with great care.

There are two main tools that the FCA has been granted in order to support its consumer protection objective which we believe require further thought.

This section sets out the CBI's position in respect of:

- *Macro-prudential tools*
- *Product intervention powers*
  - *Retail*
  - *Wholesale*
- *Early disclosure of disciplinary actions*
- *Wholesale conduct*
- *The judgement led approach*
- *Skilled persons reports*
- *Resources*

The FPC's macro-prudential tools

We look forward to the interim FPC's report to the Treasury on its recommendations for the permanent toolkit…

We welcome, in principle, the range of powers and tools that have been proposed for the FPC and agree that the FPC should set out clearly how and when it intends to use the tools. The full extent of what macro prudential policy can deliver is still unclear, particularly given the concept of macro-prudential policy itself is still in its relative infancy. This, clearly, has an impact on the extent to which macro-prudential tools can currently be judged to be appropriate.

However, it should be recognised that the powers they have will be formed as part of a wider European framework, which will ultimately be overseen by the ESRB. Macro-prudential powers that it uses in respect of banks, for example, will only be possible within the framework of CRD 4. Although we hope that this will allow the FPC considerable flexibility, within certain safeguards and constraints, this legislation has not yet been finalised. Although specific details are not yet clear, it is good that the Treasury has set out an outline of details that are available.

Given the novel nature of these macro-prudential instruments, 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 on 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.

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.

Product intervention powers

Further work is needed to ensure that sufficient controls and safeguards are put in place over the FCA's product intervention powers...

Retail

Product intervention powers are by their nature difficult to use effectively, even when there is no intention to use them to pre-approve products. We recognise that there might, in theory, be some circumstances in which product regulation could be effective if used selectively and in a well-designed framework, but these circumstances would be extremely limited.

Product regulation powers have the potential to reduce the availability and variety of products for consumers as smaller regulated firms become less likely to invest in developing new or innovative products. It can also discourage larger firms from innovating if they believe they will be penalised or restricted from developing products which do not align with criteria imposed by the regulator.

The FCA should be wary of using product intervention powers when other measures may be more appropriate to counter mis-selling. We believe that the FCA should focus on product governance throughout the product life cycle, rather than the products themselves. This would include focusing on the process of designing new products including the approval process; financial promotions and marketing; the sales process; and customer satisfaction and complaints monitoring.

More detail is needed on how product regulation will interact with product governance, what the triggers for its use will be and the appeal process. We note that the FCA will be required to consult on and publish a statement of policy governing the circumstances in which it may make temporary product intervention rules. It should consider:

- the FCA's proposed risk appetite and the criteria that must be met before the tool is used – these should be set in order that the powers may only be used when other initiatives have failed or where no alternatives can be reasonably assumed to work;

- the cost benefit analyses that should be undertaken before the powers are used;

- the length of notice that the FCA believes will be adequate to give to affected firms in advance of them being required to amend or withdraw a product; and

- the appeals mechanisms which should be defined carefully so that individual firms or groups are able to challenge the regulator's judgements quickly and receive an independent hearing.

Wholesale

We are pleased that the government has indicated that it believes that the new product intervention power is unlikely to be appropriate in relation to the protection of professional or wholesale customers, and that the Government has decided to make explicit in legislation that the FCA may not use its new product intervention power to advance the market integrity objective without HMT direction. It is not clear, however, when this power of direction would be used.

The FCA will need to be careful when it "reaches up the distribution chain" to apply the use of the tool to wholesale firms. They need to set out clearly how its approach regarding product intervention will differ for wholesale firms and their wholesale clients and the circumstances when it might apply its new powers to them.

Early disclosure of disciplinary actions

The proposed safeguards around the early disclosure powers are important but regulators must also be able to be held to account for their use…

The Government plans to grant the FCA the power to publish enforcement actions early.

We are wary that this power could have a severe effect on a firm or individual 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. Information that is published is likely to be misinterpreted by consumers, the media and market participants.

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

The Treasury has proposed a number of safeguards around the power's use (see box opposite). Although we support these safeguards that are being placed on the power, we believe that the risks that these tools present for firms who are acting in a fair, honest and compliant way are sufficiently high that further protections are required.

If these powers are to be taken forward, there must be an effective right of appeal with an independent process that can be applied in advance of publication. There must also be a process that firms can use after the publication to hold the FCA to account. This would form an essential check on the regulators to ensure that this power was used only when it was reasonable and when no other measure would achieve their regulatory objectives.

We look forward to publication of the FCA's policy on how it will exercise its power, within the safeguards imposed through legislation.

The FCA should develop its policy through a normal process of industry consultation and should publish the final policy so that it is clear to regulated firms and consumers how and when this power could be used.

Safeguards to early disclosure powers

There are a number of safeguards placed on the use of the power including requiring the regulator to consult the firm before making the disclosure and consider whether the disclosure is:

- unfair to the person with respect to whom the action was taken (or was proposed to be taken)
- prejudicial to the interests of consumers
- detrimental to the stability of the UK financial system
- prejudicial to the safety and soundness of PRA-authorised persons
- prejudicial to securing the appropriate degree of protection for policyholders

PRA rule making powers

Rules that are subject to appropriate industry consultation and the principles of good regulation will be more effective and will help reduce the risk of financial instability…

Guidance

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 supervisory relationships.

Consultation

It is important to have a framework around rule making powers that encourages a flexible and evidence based approach to rule making, because of the complex nature of FS regulation and the far-reaching implications it has for wider economy. We support the proposals for the PRA to be obliged to prepare an analysis of costs and benefits.

Sunset clauses and good regulation

There should be an automatic presumption that new rules should be subject to review after a given period of time. Putting in place an assumption that sunset clauses would be used would be a valuable control for all of the regulators.

Judgement led approach

The CBI supports a judgement based approach to regulation but more needs to be done to ensure that the approach works in practice...

Accountability and the right to challenge regulatory judgements

The FSA and Bank of England have rightly recognised that a judgement led approach can lead to circumstances where the regulator and regulated disagree, and that sometimes the regulator will be wrong. The PRA has committed to ensuring that its most senior and experienced individuals will be involved in major judgements and that they will use a process which is rigorous and well documented.

This commitment is welcome but we believe there should also be a mechanism that firms can use to challenge the decisions that the regulators make, and also that there is some form of process that firms can use to hold the regulator to account if its judgements are not reasonable.

It is to be anticipated that firms will frequently challenge decisions informally, as this discussion and debate between the regulator and its firms will help achieve the best regulatory outcomes.

Formal challenges to decisions or processes to hold the regulator to account should be used far less frequently, and the bar for their use should necessarily be set high. But these processes are needed to ensure that the regulator always takes care to ensure that their actions are reasonable.

Proportionality of approach

The regulators' approaches should be based on assessments of the risk that regulated firms pose to their objectives. We welcome the recognition that this means more than just the size of total assets. For the PRA it will also include an assessment of their interconnectedness with the rest of the financial system and the substitutability of the services that they offer. For the FCA's risk framework the assessment will depend on the size of 'incidence', based on numbers of consumers, and its 'severity'.

The regulators should work with the Financial Services industry to develop these measures in more detail.

The European framework

The great majority of new prudential regulations will be developed at a European or international level for the foreseeable future. These are likely to give macro-prudential regulators flexibility to use discretion over their use of tools, and there will still be some flexibility for micro-prudential supervisors, for example under pillar 2.

However, the development of a European single rule book will constrain the PRA's ability to use its judgement in areas where rules have been written, and even to allow waivers where they think it appropriate.

Further explanation is needed as to how the judgement led approach will operate in and interact with the European regulatory framework.

Wholesale Conduct

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

Wholesale supervision needs to be approached differently to that which relates to retail

consumers. More clarity is needed as to how this approach will operate in practice, particularly since the FCA has stated that it intends to put greater emphasis on wholesale conduct risks.

Skilled persons reports

The appropriate use of skilled persons reports needs to be set out clearly…

The use of Skilled Persons reports (or 'Section 166 reports') has become increasingly frequent over the past few years. Although they can be expensive for firms, in some specific circumstances they can be the best regulatory solution.

There is a risk that an increased emphasis on using external skills through Section 166 reports will mean that the PRA and FCA lose knowledge of specific technical areas.

More clarity is needed, in particular, as to how these will interact with the regulator's judgement led approach. If this were to occur then it is not clear that the regulator would be in a position to take judgements appropriately. The regulator will also need to take care that the scopes of its reports mean that it alone exercises its judgement, drawing on information provided by the Skilled Person, rather than delegating its judgement led approach to the Skilled Person.

Resources

Ensuring the right regulatory resources are in place is essential if the regulatory approach is to be effective…

If prudential supervisors are going to take judgements on business issues, they must have adequate knowledge to build credibility with regulated firms.

We are pleased that there is recognition by the government and at the Bank of England and FSA of the importance of the quality of regulatory staff. Practical plans that explain how high quality staff will be recruited and retained need to be published soon so that regulated firms can have confidence in the judgement led approach.

4. Co-ordination and operational issues

Effective coordination between the regulatory bodies is essential for the industry and their customers. But it can only be achieved through a combination of an effective legislating underpinning, a strong MoU between the regulators, operational arrangements that encourage coordination and corporate cultures that value engagement with the other bodies.

This section sets out the CBI's position in respect of:

- *Overall coordination of the PRA and FCA*
- *Regulatory costs*
- *Prudential supervision*
- *The PRA veto*
- *International coordination*
- *Co-ordination with FOS*
- *Authorisation and approvals*
- *Joint rule book*
- *Avoiding duplication*
- *Shared services*
- *Long term engagement of UK regulators in Europe*

Overall co-ordination of the PRA and FCA

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

The Government has stated that it would not be appropriate to set out operational matters for the PRA and FCA in primary legislation. In particular, they argued against a legislative underpinning for coordination between the regulators. Instead, the FSA and Bank plan to publish a document later in the year setting out more fully their plans to deliver operational coordination.

We look forward to this consultation as we believe co-ordination would be a significant challenge. The FSA and Bank of England should publish their consultation and engage with the industry as soon as possible.

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 to be subject to open and pragmatic external debate and consultation periodically.

We welcome the requirement for the PRA and FCA to assess how effectively they have coordinated during the year.

Regulatory costs

The regulators should be obliged to minimise costs where possible...

There is concern that the implementation of the new regulatory framework will result in increases in direct regulatory costs. Although there has been some focus on the increased costs of dual regulators arising from their regulatory approach, there has been little consideration of how the new regulatory framework will ensure that future fee increases are kept under control.

The impact assessment included in the recent HMT publication confirms that the costs of establishing

the new regulatory bodies will be substantial. The assessment also confirms that the transition costs for dual-regulated firms will be significant. The FCA will need a clear position on the future cost of regulation and how the current proposals fit within this.

The authorities need to take the opportunity presented by the change in the regulatory framework to actively consider where and how resources are best spent to prevent cost increases in areas where regulatory risks are lower. This will benefit both authorised firms and consumers, who ultimately bear the costs of regulation.

Prudential supervision

Close coordination is needed between the FCA and PRA on prudential issues…

Prudential regulatory objectives

The PRA and the FCA have different sets of objectives – whereas the PRA must contribute to the stability of the UK financial system, FCA must protect and enhance confidence in it; the PRA must promote the safety and soundness of PRA authorised persons, whereas the FCA must secure an appropriate degree of protection for consumers.

These differing objectives give rise to the potential for differences in their approach to prudential supervision. This may damage competition between firms that are close to the dividing line between being supervised by the FCA or PRA and could even be peers.

It is important that the differences in objectives and approach will not lead to a two tier regulatory regime for firms within the same industry. The legislation should reflect the need to ensure consistency in prudential regulation.

This is particularly important in the context of group supervision. The PRA's assessment of impact will cover all relevant entities within the consolidated group and in some cases it will undertake consolidated supervision. However, the current proposal is that solo prudential regulation will be split between the two regulators, even within a group. Under these circumstances the importance of proper coordination between the regulators would be paramount.

Split of responsibilities

We support the overall scope of responsibilities for each of the main bodies and we also agree that deciding the practical arrangements for dividing responsibility for prudential supervision of investment firms between the FCA and PRA is an operational issue, agreed between the regulators to ensure flexibility and precision.

However, the practical proposals for dividing responsibility for the prudential supervision of investment firms between the FCA and PRA need to be set out. The split will pose challenges for coordination, particularly where there are firms of different sizes in the same peer group. There is a risk that the regulatory structure could favour one firm over another or act as a barrier to entry to certain markets or business models. It is therefore 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.

The practical approach to the split that the regulators devise should be developed within a legislative framework of procedural safeguards and clear and transparent principles. These principles should be linked to both regulators' objectives and provide a clear and stable framework within which the scope of each regulator's responsibility can be set.

The FCA's prudential approach

The FCA will supervise the majority of its firms on a 'gone concern' basis, from a prudential perspective. However, it will aim to supervise some larger firms on a 'going concern' basis, for example large asset managers and investment firms that deal as principle. This is consistent with the PRA, which will supervise all of its firms on a 'going concern' basis.

The difference between 'gone' and 'going' concern relates to whether the objective of the prudential supervision is to ensure that a firm can be wound down in an orderly manner, or whether it should have a focus on reducing the likelihood that it fails.

There is, however, a large difference between these two approaches and size is not necessarily a good indicator of the risk that a given firm will pose to the FCA's objectives.

The legislation should reflect the need to ensure consistency in prudential regulation. There may, consequently, be an argument for extending the 'going concern' approach to investment firms that deal as principle but not to even large asset managers where not required by underlying European legislation.

The FCA will need to set out clearly, and be held to account on, how its prudential regulatory approach aligns with the objectives it has been set.

PRA veto

Further thought should be given as to how to the veto would be used in relation to rule making and waivers…

The PRA has been granted a veto over the FCA on the basis that it can be used if the action proposed by the FCA would:

- threaten the stability of the UK financial system; or
- result in the failure of a PRA-authorised person in a way that would adversely affect the UK financial system.

We recognise that there are circumstances when the veto may need to be used, but further consideration should be given to how it would be used in relation to rule making and waivers, and where the action relates market abuse or criminal prosecutions.

Coordination with the Financial Ombudsman Service

The Financial Ombudsman Service is essential for regulated firms and consumers but it must work closely with the FCA to ensure consistency…

The FOS has a key role in ensuring that complaints against regulated firms are dealt with appropriately. The FOS framework helps the efficiency of the complaints process and avoids the need on either side for lengthy and costly court battles. But there are elements of its governance, working practices and powers that need reform. One element that needs to be improved is its interaction with the FCA.

In the past, the FOS has taken rulings on individual cases which have then effectively set a precedent for future complaints reviews. This has raised concerns about the reasonableness of its judgements when considered in the context of the accountability of the process used to develop FSA rules and compared with the expectations that the regulator had at the time that the issue arose.

The FOS should be required to view complaints in the light of the conduct rules and guidance existing at the time that the issue arose. It should not be able to extend its ability to take judgements on individual cases to set general regulatory policy.

Where the FOS takes decisions that are novel or are likely to set standards for wider groups of complaints or policy for regulated firms more generally, they should be required to refer the decision to the FCA. The FCA should be the body which takes the decision to set standards about firms' behaviour and conduct of business. This will help ensure consistent treatment of consumers across the industry.

Similarly, where the FCA takes a decision on the approach that firms should use in respect of a specific issue that applies across the industry, the FOS must be required to follow that decision and must make its rulings in accordance with it,

whether or not it arises from a referral from the FOS.

International Regulatory Committee

Full and proactive engagement in the European regulatory regime is essential for stability, and an International Regulatory Committee, required by statute, would aid this process dramatically…

It is vital that the regulators are able to influence the European regulatory regime. To do this they must actively engage with the European debate. This is especially crucial given the lack of a single regulator to voice UK concerns, as has been the case under with the FSA. There must be recognition that there has been a shift in Europe on regulatory issues, and that the new approach may well be more prescriptive.

Practically, UK representation on international and European regulatory bodies, committees and fora is essential if the regulators are to achieve their regulatory objectives. They must also engage actively with overseas regulators and regulatory colleges to ensure that supervision of individual firms and groups is appropriate.

Effective international coordination is a priority for the financial services industry, and we believe that the need for strong international regulatory influence is such that it requires a legislative underpinning.

The legislation already requires an MoU to be put in place between the PRA and FCA. It should also mandate the establishment of an executive level international coordination committee, directly accountable to Boards of the regulatory bodies and ultimately to the Treasury.

This will ensure that the views of both regulators are represented and that the right expertise is deployed when necessary, for example if a discussion at ESMA is relevant for the PRA's prudential supervision.

UK regulators must also have the right level of skills in order that their interaction with European bodies is effective. This will include soft skills such as negotiation and influencing, as well as technical skills to influence the debates.

The International Regulatory Committee

The legislation should mandate the establishment of an executive level international coordination committee, directly accountable to Boards of the regulatory bodies. The committee should be comprised of representatives of the PRA and FCA and would oversee and be responsible for the regulators' international engagement.

The committee's mandate should 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 committee itself could benefit from a joint secretariat which will work at an operational level across the two organisations.

The regulators must also ensure that they are well coordinated when dealing with non-EEA 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.

Authorisation and approvals

An effective, transparent and swift authorisation process is essential for competition in the financial services industry…

We are pleased that the Government has decided to adopt the 'alternative approach'. It is logical that the authority with prudential responsibility should take the lead role in the authorization process. This will make the process more administratively efficient and avoid duplication of resources but, more importantly, reduces the risk that important elements of the applicant's business model or controls go unchallenged.

This introduction of this approach is also a good opportunity to improve the existing authorisation process. The impact of the timescales and administrative difficulties involved in becoming authorised is difficult to measure objectively but it is possible that it discourages new entrants, particularly where they are not raising funds from single sources or are proposing innovative business models.

It is important that the authorization process, and the process for cancelling permissions, is made as efficient as possible.

Joint rule book

A joint rule book would fit with the European approach to regulation, as well as removing complexity…

The approach to rule making and supervision will differ between the two regulators. But from a practical perspective combining the rules within a single Handbook, as is currently the case with the FSA, will make it simpler for firms to apply. Given the size of the current Handbook, the benefit of this should not be underestimated. An overcomplicated structure of rules will increase the chances that firms, particularly smaller firms, are not compliant, as well as increasing the overall cost of regulation.

A large proportion of the rules in the rule books will be made at a European level which is also pursuing a single rule book project. The proportion of the rules which arise from Europe is likely to increase and the UK legislators and regulators should reflect this in their design of the UK rule book.

Avoiding duplication

Co-ordination and efficiency could improve through the use of a single channel between firms and regulators…

The potential for duplication and inefficiencies or underlap between the regulators is clear. This duplication is most obvious in an administrative sense – for example duplicate supervisory visits or reviews; or requests for similar but different information.

Duplication could also clearly arise in a more general policy sense. For example, the two regulators could introduce conflicting rules or regulatory action to address risks which arise in respect of a certain service or product. Costs arising from the duplication of supervision could in both of these cases be greater than the sum of each being undertaken independently.

This should be addressed by minimising the points of contact between firms and the dual regulators. A requirement to use a single channel or point of contact would be one way of improving efficiencies and coordination.

Long term engagement of UK regulators in Europe

A long term strategy for using the UK's financial services expertise to influence and help improve the European regulatory process is essential…

The UK has the leading financial services industry in Europe and it is essential that the PRA and FCA are engaged with European regulators and legislators at all levels.

There are practical issues of international coordination that need to be managed over the next few years as the UK reforms its regulatory architecture. However, this time of reform is also an opportunity to ensure that the UK's financial sector is fully engaged in the European regulatory process.

London is the leading European financial centre and the expertise found in the UK cannot be found elsewhere in Europe. It is therefore important that the UK has a commensurate level of influence at the European regulatory bodies and throughout the policy and legislation process.

The only way that this can be achieved is by establishing practical arrangements for the PRA and FCA at all levels to engage with the ESAs and the European Commission. Not only will this help the UK contribute meaningfully to the debate as it arises, but it will also put those with practical expertise at the heart of the policy making process, improving legislation and financial stability over the long term.

This must work well at a senior level, as they will shape today's debate, but it is also important to get more junior staff engaged as they will be influential over the longer term.

The UK financial services industry would support proposals for practical and operational engagement by the UK regulators in Europe, including secondments.

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CBI
THE VOICE OF BUSINESS

Appendix A – Summary of consultation questions

1 Do you have any specific views on the proposals for the FPC as described in paragraphs 2.6 to 2.24 and in Chapters 3 and 4?

See "FPC objectives" in Chapter 1: Objectives and Principles, and Chapter 2: Governance and Accountability.

4 Do you have any comments on the objectives and scope of the PRA, as described in paragraphs 2.46 to 2.61 and in Chapters 3 and 4?

See "PRA and FCA's objectives – competitiveness" and "PRA's insurance objective" in Chapter 1: Objectives and Principles.

5 Do you have any comments on the detailed arrangements for the PRA described in paragraphs 2.62 to 2.78 and in Chapters 3 and 4?

See Chapter 2: Governance and Accountability; "Judgement led approach" in Chapter 4: Coordination; and "PRA rule making powers" in Chapter 3: Powers and Regulatory Approach

6 Do you have any views on the FCA's objectives – including its competition remit - as set out in paragraphs 2.80 to 2.90 and in Chapters 3 and 4?

See "PRA and FCA's objectives – competitiveness", "FCA's competition duty", "Principles of Regulation", and "Definition of Consumer" in Chapter 1: Objectives and Principles. Additionally, please also note the section on "FCA Scope".

7 Do you have any views on the proactive regulatory approach of the FCA, detailed in paragraphs 2.91 to 2.110 and in Chapters 3 and 4?

See "FCA's Conduct of Business Powers" in Chapter 3: Powers and Regulatory Approach, as well as "Prudential Supervision of Investment Firms", "Skilled persons reports", and "Wholesale Conduct" in Chapter 4: Regulatory Activities.

Additionally, please also note the section on "Resources" in Chapter 3: Powers and Regulatory Approach.

10 Do you have any comments on the competition proposals for the FCA set out in paragraphs 2.111 to 2.119 and in Chapters 3 and 4?

See "FCA's competition duty" in Chapter 1: Objectives and Principles.

12 Do you have any comments on the governance, accountability and transparency arrangements proposed for the FCA, as described in paragraphs 2.124 to 2.132 and in Chapters 3 and 4?

See Chapter 2: Governance and Accountability.

13 Do you have any comments on the general coordination arrangements for the PRA and FCA described in paragraphs 2.138 to 2.149 and in Chapters 3 and 4?

See "Overall co-ordination of the PRA and FCA" in Chapter 5: Co-ordination, including particularly the sections on "Single point of contact" and "Joint rule book". The sections "International Regulatory Committee" and "Long term engagement of UK regulators in Europe" applies to the co-ordination arrangements between the PRA and FCA, but also to sections 2.205 to 2.206 in "A new approach: the blueprint for reform".

14 Do you have any views on the detail of specific regulatory processes involving the PRA and FCA, as described in paragraphs 2.150 to 2.195 and in Chapters 3 and 4?

See "Authorisation" in Chapter 5: Co-ordination; and "PRA rule making powers" and "Prudential Responsibilities of the PRA" in Chapter 3: Powers and Regulatory Approach.

15 Do you have any comments on the proposals for the FSCS and FOS set out in paragraphs 2.196 to 2.204 and in Chapters 3 and 4?

See "Co-ordination with the Financial Ombudsman Service" in Chapter 5: Co-ordination.

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

2 Do you have any specific views on the proposals for the Bank of England's regulation of RCHs, settlement and payment systems as described in paragraphs 2.32 to 2.40 and in Chapters 3 and 4?

3 Do you have any comments on:

- the proposed crisis management arrangements; and
- the proposals for minor and technical changes to the Special Resolution Regime as described in paragraphs 2.41 to 2.44 and in Chapters 3 and 4?

8 What are your views on the proposal to allow nominated parties to refer to the FCA issues that may be causing mass detriment?

9 What are your views on the proposal to require the FCA to set out its decision on whether a particular issue or product may be causing mass detriment and preferred course of action, and in the case of referrals from nominated parties, to do so within a set period of time?

11 Do you have any views on the proposals for markets regulation by the FCA, described in paragraphs 2.120 to 2.123 and in Chapters 3 and 4?

The blueprint for reform

8 September 2011

Our Ref: PD20010900

A new approach to financial regulation: the blueprint for reform

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 take complaints 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.

Main principles to protect consumers

We have previously outlined our policy positions on regulation and how it protects consumers to the Treasury and we welcome the opportunity to comment further.

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.

There must be complete clarity around the ability of each regulator to take decisions within its area of focus and expertise. This will ensure that important tasks and issues that protect consumers do not fall between the bodies. This also extends to other regulators and government agencies. A new charter must be available to clearly outline the responsibilities of both consumers and financial institutions.

We seek assurance that the roles of the new bodies must be communicated clearly. All consumers must understand how they will be protected and where to seek redress if appropriate.

We welcome Financial Conduct Authority (FCA) plans to do more than the Financial Services Authority (FSA) has done to engage directly with retail consumers and to explain what they can expect from a regulated firm and

from the FCA itself. This is vital as the title of the organisation does not clearly describe its function in relation to consumer protection.

The service provided by the Financial Ombudsman Service (FOS) must continue to be promoted so that consumers in Northern Ireland understand the role of the FOS and how to interact and make a complaint.

A robust system:

The financial regulation system must be robust enough to identify financial products or behaviours that might cause customer detriment. The system must also be flexible enough to respond urgently to identified detriment and take necessary and appropriate actions. The Government must ensure that the interests of consumers are placed at the heart of the regulatory system and given the appropriate degree of priority. The level of protection offered to consumers throughout the transition period must also be maintained.

In order for the FCA and Prudential Regulation Authority (PRA) to identify emerging detriment problems at an earlier stage and use new tools of intervention, such as banning products, a change in behaviour and culture will be required. This must involve staff training, a change in the strategic direction of the organisations, plus a range of practical measures to bring about cultural change.

Prudential Regulation

From a consumer perspective the challenge for prudential regulation is to create a regulatory system that strikes the right balance between:

- Providing appropriate consumer protection and promoting the necessary consumer confidence; and
- Promoting market efficiency, avoiding moral hazard and unnecessary system costs which may ultimately be passed onto consumers and lead to greater financial exclusion.

The Prudential Regulation Authority (PRA) will have the authority to make high impact decisions affecting all consumers. The PRA must work closely with the Financial Conduct Authority (FCA) to understand issues concerning consumer detriment and how their decisions impact consumers, taking advantage of the FCA's remit to cover consumer issues. The PRA must also consult with consumers and their representatives as part of its processes.

Prudential regulation must be robust yet flexible to deal with continual changes to products and the landscape. For example, novel financial instruments are being increasingly used by financial institutions to manage liabilities. The proposed judgement-led regulation will be a new approach and as such will require a culture change, allowing the proposed senior and expert teams to make forward-looking judgements and take necessary action.

Equivalent to the FCA, the PRA should have product intervention powers. This should also include the ability to make temporary product intervention

rules. Given the huge impact the activities of the major institutions have on consumers, it is arguably even more important that the PRA has powers of intervention.

Conduct Regulation

Much more work is needed to ensure consumers can 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 as well as have all the relevant information to make the decision.

The government has acknowledged that financial inclusion will be an important issue to address and the FCA has a mandate to do so under its efficiency and choice objective. The Consumer Council would seek clarity on how the FCA proposes to take forward this key issue. We believe financial service providers should work to design products and structures that help all consumers to access and benefit from services such as bank accounts and insurance.

The regulation of products needs to be clear in order to protect vulnerable consumers. We believe there is a need for providers to highlight and make sure that consumers understand the risks and high interest rates and charges for these products.

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 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.

The Consumer Council welcomes the additional tools that the FCA will have to facilitate consumer redress. The government has also put forward a proposal that, if and when there may be a need for large-scale consumer redress, there is a clear process in place to ensure that the issue is tackled by

the FCA thoroughly and promptly. The Consumer Council is already recognised as a designated supercomplaint body under the Enterprise Act 2002. It is essential that the Consumer Council would be able to make a referral where we think that there may be mass consumer detriment. This would require the FCA to respond within a certain time period and, where appropriate, set out the action it intends to take.

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 and their 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 issues must be embedded across the entire regulatory structure.

We welcome the proposal to ensure a customer perspective will be built into all of the FCA's work, along with maintaining effective relationships with consumer representatives. This must also be the case in the PRA. We look forward to seeing how this will work in practice. Communications must be meaningful and two way between consumer organisations and the regulator. 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.

Consumer education:
It is vital that organisations such as the FCA and 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 to financial capability.

The Consumer Council leads the Financial Capability Partnership NI which brings together Government, banks, building societies, credit unions, education, community and voluntary sectors to ensure that we all help consumers in Northern Ireland to manage their money and make it work best for them.

Further consultation with the Consumer Council

We hope you will find this information useful. We look forward to working with the Treasury on other aspects of financial regulation reform. We would appreciate further information and an update on the Government's plan to address financial inclusion.

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.

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CONSUMER CREDIT Counselling Service

A Registered Charity

Response to HM Treasury consultation on: A new approach to financial regulation: the blueprint for reform

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 White Paper on financial regulation and draft Bill.

CCCS is run independently of taxpayer money on the basis of a unique set of relationships with 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.

Therefore, our main points are:

- The FCA should be established as the equal of the PRA and not its junior partner so that consumers have the confidence that they will be treated fairly. Consumer protection should be a strategic objective for the FCA or at least its highest operational priority (as we suggest in our response to Q6)
- There should be consumer representation on the FPC (Q1)
- People with a background in consumer advocacy should be members of the FCA's governing body (Q12)

- The Government should either retain a consumer panel for the PRA or ensure it sets out a wider strategy for engagement with consumer representatives (Q5)
- The PRA should at the very least be required to publicly explain why it has resorted to using its veto power, as its use implies regulatory failure (Q13).

Specifically, CCCS will be directly affected by any decision to transfer responsibility for the regulation of consumer credit from the Office of Fair Trading (OFT) to the FCA. Though this proposal is currently under review, the FCA needs to be geared to hit the ground running in this area, not least because of the risks of serious and long-term consumer detriment. Therefore we strongly urge the government to establish the FCA as a shadow regulator from the outset in anticipation of any such transfer.

Our response to the following consultation questions is based on the interests of our clients – both current and potential – and their relevance to our work. A recent report for the charity by the Financial Inclusion Centre (using CCCS data and other sources) found that 3.2 million households are in persistent arrears (or subject to insolvency action), with a further 3 million at risk of falling behind with repayments[1], underlining the importance of an improved regulatory regime.

1. Do you have any specific views on the proposals for the FPC as described in paragraphs 2.6 to 2.24 and in Chapters 3 and 4?

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. Further, we share the view of the Treasury Select Committee that membership of the FPC may be too narrow, in particular in its heavy weighting toward the Bank and financial service industry representatives. As the Committee have pointed out:

> "[There should be a] diverse range of experience and views [to] contribute to the development of macro-prudential policy."[2]

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[1] CCCS-commissioned report, *Debt and Household Incomes*, 12 July 2011 http://www.cccs.co.uk/Portals/0/Documents/media/reports/additionalreports/Report_Debt_and_household_incomes.pdf

[2] Treasury Select Committee, *Appointments of Michael Cohrs and Alastair Clark to the interim Financial Policy Committee, Fourteenth Report of Session 2010-12*, 8 June 2011. http://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/news/interim-fpc-appointments-/

For both these reasons, we believe 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 one direction over another.

In addition, we support proposals for the FPC to report on the effectiveness of its actions, but would like to see this extended to include assessment of their impact on consumers.

As part of its focus on unsustainable levels of debt, we hope the FPC will take into account data already available through existing channels, such as that provided by CCCS. A recent report by the Financial Inclusion Centre, commissioned by CCCS, urges the government and regulatory authorities to develop better intelligence on household borrowing, including more detailed information about financially vulnerable consumers. This would allow policymakers to better understand the implications of macro-level decisions, allow finite resources to be targeted more efficiently and help better secure consumer protection[3]. While the report's recommendations are its own, we believe better intelligence will be an essential component of an improved regime.

2. Do you have any specific views on the proposals for the Bank of England's regulation of RCHs, settlement and payment systems as described in paragraphs 2.32 to 2.40 and in Chapters 3 and 4?

3. Do you have any comments on:

- **the proposed crisis management arrangements; and**
- **the proposals for minor and technical changes to the Special Resolution Regime as described in paragraphs 2.41 to 2.44 and in Chapters 3 and 4?**

4. Do you have any comments on the objectives and scope of the PRA, as described in paragraphs 2.46 to 2.61 and in Chapters 3 and 4?

While we agree that the PRA's strategic objective to contribute to the stability of the financial system is an important goal, we are concerned that practices that cause harm to consumers will not be properly addressed when they are so widespread or entrenched that the costs of correcting behaviour are deemed too risky for overall stability.

Enabling the PRA to overrule the body charged with consumer protection risks sending a message to firms that they will not be forced to bear the full consequences of mistreating consumers.

At the very least (cf Q13), we believe the PRA should be required to publicly explain why it has resorted to using its veto power, as its use implies regulatory failure on the part of the FCA, the PRA or both regulators to achieve their objectives.

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[3] *Debt and Household Incomes*, p46-7

5. Do you have any comments on the detailed arrangements for the PRA described in paragraphs 2.62 to 2.78 and in Chapters 3 and 4?

We are concerned that plans to scrap the consumer panel for the PRA will put further distance between consumers and the decision-making process. While the PRA is required to consult the FCA in its decision-making, the FCA itself – unlike the Panel – is not set up to represent consumer concerns.

In any event, the weaker duty for the PRA to consult the conduct regulator – rather than having regard to its objectives – risks it being sidelined. Without a proper balance between prudential and consumer concerns, ordinary consumers of retail products may continue to lack the degree of regulatory focus or protection they expect or require. In coming to decisions and analysing their impact, the PRA should not neglect consumer outcomes.

To ensure that consumer issues are at the heart of the new regime, the Government should either retain a consumer panel for the PRA or ensure it sets out a wider strategy for engagement with consumer representatives. The latter might see the PRA set up regular working groups that assess the impact of its decisions with consumer bodies and charities that have an interest in financial matters.

6. Do you have any views on the FCA's objectives – including its competition remit – as set out in paragraphs 2.80 to 2.90 and in Chapters 3 and 4?

We welcome the intention to make consumer outcomes a central focus of the FCA.

We assume that the FCA's strategic goal – to protect and enhance confidence in the financial system – ultimately implies that the "confidence" which matters is the confidence of *consumers* that they will be well served by the financial system. This could be more clearly spelt out.

CCCS is concerned that simply restating one of the FSA's current statutory objectives will not be enough when it comes to consumer protection. While we welcome the FCA's new powers (see Q7), the massive detriment suffered by consumers under the previous regime – not least through the misselling of PPI – means that the new conduct regulator will have to operate with a clearer vision of what securing its consumer protection objective looks like.

Further, it is unclear whether consumer protection will be given priority when it conflicts with other operational objectives. We therefore urge the Government to make consumer protection part of the FCA's strategic objective or at the very least its highest operational priority.

7. Do you have any views on the proactive regulatory approach of the FCA, detailed in paragraphs 2.91 to 2.110 and in Chapters 3 and 4?

CCCS is hopeful that the new powers being given to the FCA will help protect consumers from the dangers of over-complex products and sophisticated sales techniques. It is encouraging to see that the FCA will not be mandated to promote competition when this is incompatible with its strategic or operational objectives.

CCCS will be directly affected by the potential transfer of all consumer credit regulation to the FCA – the charity takes action on behalf of its clients to help them manage their consumer credit commitments and holds its own consumer credit licence. We strongly support proposals that would bring together the regulation of mortgage and non-mortgage credit products under one authority.

In our experience, there is risk of more significant detriment in consumer credit than in any other area of retail financial services. As the OFT point out:

> "The choices that consumers make to tackle their debt problems can have serious consequences both in terms of immediate financial cost, and long-term knock-on consequences on availability and cost of future credit."[4]

The OFT's recent probe into debt management companies underlines the need for effective regulation in this area. We believe, therefore, that the FCA should be set up as a consumer credit regulator in shadow form from the outset. A report by the Financial Inclusion Centre, commissioned by CCCS, outlines a plan of action that could be taken in this regard[5]. While we have reservations about some of the report's recommendations, it demonstrates the scope of action that the regulator will need to embark on.

In addition, we note the Government "retains an open mind" (2.86) as to how the FCA will secure its operational objectives in relation to its competition remit, especially with regards to consumer protection. The FSA has recognised that success in securing effective competition in some retail markets will only occur if the FCA tackles the underlying characteristics of the market to promote "informed choice".[6]

However, rather than an informed choice, the consumer of debt management services is typically making a "distress purchase". The Money Advice Trust has produced research showing that people who are over-indebted, vulnerable and desperate for help tend to make quick decisions about complex and often unfamiliar debt solutions and tend not to shop around[7]. Consequently, consumers are more likely to purchase the services of the first company they come across, regardless of its ability to provide appropriate advice. Any competitive pressures are thus substantially diluted.

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[4] OFT, *Debt Management Guidance Compliance Review,* September 2010

[5] *Debt and Household Incomes* pp43-7

[6] FSA, *The Financial Conduct Authority: Approach to Regulation*, June 2011

[7] MAT, *An independent review of the fee-charging debt management industry*, June 2009

Given these circumstances, a consumer of debt management services would be in a much better position to make an "informed choice" if:

- Debt management companies were compelled to state the availability of free services in their advertising;
- Firms were required to point to clear guidelines about exactly what options are available to debtors, ensuring consumers are not just informed about the most profitable debt solutions.

These are proposals that CCCS will also be submitting to the FCA as it consults on its regulatory approach.

8. What are your views on the proposal to allow nominated parties to refer to the FCA issues that may be causing mass detriment?

We strongly support the proposal to give designated groups a statutory role in the evidence-gathering process so that the FCA is obliged to respond and investigate if it determines that there is an issue causing mass detriment.

Debt advice agencies like CCCS are well-placed to submit evidence with a view to early intervention when clients are suffering due to bad practices.

Many people counselled by CCCS have been poorly served by the financial services industry, whether in terms of the appropriateness of products they have been sold, their level of indebtedness, or the so called solutions they have been offered to mitigate or manage their debt problems.

Our main concern would be to ensure that bodies applying to become designated groups should meet rigorous criteria, similar to that for groups wishing to become super-complainants. This would guard against a "free-for-all" and reduce the likelihood of vexatious complaints, in turn increasing the legitimacy of the process and reducing the risk of costs being passed on to the consumer.

9. What are your views on the proposal to require the FCA to set out its decision on whether a particular issue or product may be causing mass detriment and preferred course of action, and in the case of referrals from nominated parties, to do so within a set period of time?

We support these proposals and believe they have the potential to improve the regulatory culture to bring swifter and more effective redress for consumers.

However, it should be pointed out that regulatory transparency will have more impact on the conduct of firms when there is a truly competitive market, which is not the case in many areas of financial services.

10. Do you have any comments on the competition proposals for the FCA set out in paragraphs 2.111 to 2.119 and in Chapters 3 and 4?

11. Do you have any views on the proposals for markets regulation by the FCA, described in paragraphs 2.120 to 2.123 and in Chapters 3 and 4?

12. Do you have any comments on the governance, accountability and transparency arrangements proposed for the FCA, as described in paragraphs 2.124 to 2.132 and in Chapters 3 and 4?

We welcome the fact that the FCA board will have a majority of non-executive members, but would prefer to see positions of governance at the FCA filled through a process of open competition rather than Treasury/BIS appointment.

As with the FSA, it is essential that people with a background in consumer advocacy are members of the FCA's governing body – this will boost confidence in the authority's consumer protection agenda.

The FCA should be as outward-facing as possible. The statutory Consumer Panel should be adequately resourced and mechanisms should be put in place to ensure its research, findings and advice are given due consideration by the FCA board and senior executive.

Further, the focus and composition of the Panel will need re-assessment if and when consumer credit responsibilities are transferred from the OFT to the FCA.

13. Do you have any comments on the general coordination arrangements for the PRA and FCA described in paragraphs 2.138 to 2.149 and in Chapters 3 and 4?

We are concerned that the PRA's veto power indicates that conduct and consumer protection issues will take second place to prudential regulation under the new regime.

Further, as has been pointed out:

> "[T]o permit the PRA to overrule the FCA sends a dangerous message to the industry that only firms which are small enough to fail without causing damage to financial stability will be forced to bear the full consequences of mistreating consumers."[8]

The Government has said that transparency will be an important factor in ensuring the PRA and FCA coordinate well. It is therefore unclear why the PRA should not at minimum publicly explain why it has resorted to a veto, as its use implies regulatory failure on the part of at least one of the new regulatory bodies.

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[8] Which?, *A new approach to financial regulation: building a stronger system – consultation response*, 14 April 2011

14. Do you have any views on the detail of specific regulatory processes involving the PRA and FCA, as described in paragraphs 2.150 to 2.195 and in Chapters 3 and 4?

15. Do you have any comments on the proposals for the FSCS and FOS set out in paragraphs 2.196 to 2.204 and in Chapters 3 and 4?

Consumer Credit Counselling Service
September 2011

Consumer Focus response to HM Treasury on the Draft Financial Services Bill

September 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 and have statutory powers, granted to us by Parliament in 2008, to tackle consumer detriment and represent the interests of UK consumers.

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Executive summary

The impetus for this legislation is not only the financial crisis and its attendant affects, but also the waves of misselling by financial institutions which have caused hardship and wasted the money of so many consumers. Financial products are essential to society. We need people to save and invest, to use credit wisely and to take out insurance so they and their families are protected if things go wrong. To do all these things consumers need to know that their money is safe and that the products they buy are useful and offer good value for money. This then is crucial legislation and Parliament has a once in a generation opportunity to get it right.

Since the Financial Services and Markets Act 2000 (FSMA) was enacted we have experienced pensions misselling; endowment mortgage misselling; the failure of Equitable Life; split capital investment trust misselling; unfair credit card terms; unfair unauthorised overdraft charges; policy protection insurance misselling; and a major banking crisis. The new regime must be more effective at ‘upstream’ prevention. The Financial Services Authority (FSA) has learnt many lessons since FSMA was passed and strengthening the regime would benefit both consumers and the financial services sector.

The Financial Conduct Authority (FCA) will have a wide range of responsibilities and, if the consumer credit regime moves from the Office of Fair Trading (OFT), a huge number of firms to regulate. The challenges are significant.

It is worth noting that any regulatory structure can be made to work given the right powers, tools, wider stakeholder engagement, and culture. What is crucial however is getting the statutory framework right, particularly in terms of statutory objectives, as this drives regulatory behaviour and approach. We argue for more transparency and accountability of the new regulatory bodies and against a veto by the Prudential Regulation Authority (PRA) on the actions of the FCA.

Regulatory frameworks in other sectors place consumer interests at the heart of their regimes. We consider there to be a strong case for the consumer interest in the new framework to be strengthened if we are to avoid further crises and damage to confidence and a sustainable financial system. We make the case for a change to the definition of the consumer so that it is clear who the FCA is protecting.

While stability is an important overall objective, it is surely not the only one for any public body. There must also be a concern for access to, and value of, financial services as they provide the oil on which the engine of the economy runs. It must be recognised that stability has an ‘opportunity cost’. If a regulator only looks at stability it can too easily place restrictions on the supply, and cost of, credit to the wider economy. This could reduce access to essential financial services and push up prices. We are concerned that there is nothing in the statutory framework to limit the Bank or the FPC’s discretion in this regard.

We also recommend changes to the objectives and ‘have regards’ of the FCA to make it focus on the outcomes that will benefit consumers and recognise their behaviour. In particular we challenge the arguments behind the concept of consumer responsibility in financial services.

We feel strongly that promoting effective competition needs to be more central in the new regime. Competition will be more effective at delivering many consumer benefits, in the longer term, than regulation.

We welcome the Treasury White paper and consultation.

Introduction

Consumer Focus welcomes the draft Bill and Government's commitment to improve the regulatory framework for financial services to prevent many of the financial and consumer crises we have seen in recent times.

It is critical that the statutory objectives set by Parliament for each body within the new regulatory architecture are well defined and understood, and that the institutions have the right mix of over-arching objectives, duties and powers to provide them with the tools and capacity to deliver. The relationship between the new bodies and the Treasury also needs to be clear.

We have only answered those questions that have a direct bearing on the interests of consumers, and have focused especially on questions 6, 7 8, 9 and 10. The numbering of sections in the rest of this document follows the numbering set out in the Treasury's consultation paper.

Our response draws on our submission to the Joint Parliamentary Committee that is scrutinising this Bill and to whom we will provide oral evidence on 15 September 2011

Our evidence

Question 1 FPC objectives

We do not believe the Financial Policy Committee's (FPC) objectives are satisfactory. While the FPC's primary objective should clearly be appropriate stability, there is nothing in the draft Bill that ensures they take into account the consumer interest. The consultation paper suggests that the FPC should take into account the 'ability of the financial sector to contribute to the UK economy' but this is too vague. It could potentially be interpreted as meaning the vitality of the City of London rather than what benefits the financing industry offer the economy to function as a whole.

The FPC needs instead a tighter remit which is explicit about access to and price of financial products, such as credit, not the performance of banking groups specifically. Central to the correct goals are the banks' ability to lend and also the vitality of competition. The formulation of the Bank of England and the FPC's stability goal is silent on these issues.

Stability and competition are seen by some to fit poorly together. There may be an 'opportunity cost' to a focus solely on stability. We fear stability in the financial service markets will be pursued at the cost of genuine consumer-led competition and choice. Pursuit of effective competition may in occasional circumstances make maintaining stability a harder challenge. Yet from the consumer (and wider economic) perspective, effective and meaningful competition brings large efficiency gains, innovation, and better value products.

Excessive capital and liquidity requirements to make banks 'safe' serve to decrease the availability and increase the price of credit for consumers and small businesses. In addition, the takeover of HBOS by Lloyds TSB at the height of the banking crisis was allowed on financial stability grounds despite breaching normal competition law requirements. Both these examples demonstrate how policies to ensure stability may lead to consumer detriment. The potential tension between the policy goals of competition and stability needs to be recognised and resolved in the new regime.

The consultation refers to the mechanisms that will be put in place between the Treasury and the FPC to ensure its actions are responsive to macroeconomic conditions. This includes the use of additional macroeconomic tools to ensure the FPC can respond flexibly and appropriately to conditions as they evolve. We support these tools but we do not believe the accountability arrangements for the FPC set out in the draft Bill are adequate.

We would like additional accountability mechanisms beyond those proposed between the FPC and the Treasury. The FPC will have an unprecedented suite of policy responsibilities and powers. The way in which the FPC and its subordinate bodies choose to discharge this cluster of important functions could have significant implications for the UK economy and the welfare of citizens and consumers, but there is no inbuilt public accountability mechanism for the FPC overall nor for large parts of its activity, other than retrospective reporting.

There will need to be open and public debate about the extent to which greater stability on the one hand and economic growth and jobs on the other should be balanced. Ultimately democratically elected Ministers should be accountable for such trade-offs, yet the draft Bill leaves too much discretion in the hands of the FPC.

The FPC currently has no obligation in the draft Bill to consult on its plans – reflecting the culture of its central bank history where business is typically conducted behind closed doors. We believe that the FPC must become more transparent and accountable than is set out in the draft Bill. This should include being required to consult publicly on how it plans to exercise its powers and the criteria and analysis upon which it will base its decisions to act.

Equally, the constitution of the FPC membership is not acceptable, with inadequate independent public interest representation (as proposed it comprises the governor, five senior bank executives, four independent directors and the FCA CEO). At least one of the FPC members should have relevant expertise in representing the consumer interest, and there should be a majority of independent directors with relevant expertise.

Question 2.

We do not believe the accountability arrangements set out in the draft Bill are adequate for the Bank of England Group. The new Bank of England (BoE) and its constituent parts will have an unprecedented suite of policy responsibilities and powers. These include: monetary policy; financial stability; prudential regulation of banks and other credit institutions, insurers and major investment firms; resolution authority for banks and other major institutions; oversight of payments and clearing systems; and provider of special liquidity including lender of last resort.

The way in which the Bank and its subordinate bodies choose to discharge this cluster of important functions could have significant implications for the UK economy and the welfare of citizens and consumers, but there is no inbuilt public accountability mechanism for the Bank overall nor for large parts of its activity, other than retrospective reporting. As with our answer to question 1 above, we believe these need strengthening.

Oversight of payment systems

The BoE was recently given statutory oversight of payment systems under the Banking Act 2009 including inter-bank payment schemes. The Bank's oversight is largely in the context of financial stability, recognising the crucial need to maintain the integrity of payment systems in the event of failure of a major bank or other institution. There are important consumer and competition issues with respect to the UK's payment systems however, as the recent controversy around the phasing out of cheques has shown. We therefore suggest that the FCA be charged with a statutory responsibility for the consumer protection and competition elements of payment systems, and that both the FCA and the Bank be given duties to co-operate with each other on Payment system regulation.

The Draft Bill already proposes joint regulation by the BofE and FCA in recognised clearing houses (para 2.33). We call for similar co-ordination mechanisms to be put in place to ensure the effective regulation of payments infrastructure.

4. Objectives and scope of the PRA

We do not believe the PRA's objectives are satisfactory. While the PRA's primary objective should clearly be appropriate stability, there is nothing in the draft Bill that ensures they take into account the consumer interest – or indeed the fair and efficient functioning of the market as a whole – when making decisions. The Draft bill (para 2.50) recognised that some respondents to the previous consultation had suggested that there should be a reference to the promotion of competition, choice and diversity.

We believe instead of adding specific duties it would be best for the PCA to have regards the FCA objectives. Currently, the PRA has no duty to have regard to the FCA objectives, most notably on consumer protection and promoting competition.

Stability and competition are seen by some to fit poorly together. There may be an 'opportunity cost' to a focus solely on stability. We fear stability in the financial service markets could be pursued at the cost of genuine consumer-led competition and choice. Pursuit of effective competition may in occasional circumstances make maintaining stability a harder challenge. Yet from the consumer (and wider economic) perspective, effective and meaningful competition brings large efficiency gains, innovation, and better value products.

As stated in question 1, excessive capital and liquidity requirements to make banks 'safe' serve to decrease the availability and increase the price of credit for consumers and small businesses. The potential tension between the policy goals of competition and stability needs to be recognised and resolved in the new regime.

Para 2.52 of the consultation indicates that additional safeguards with regards competition will be put in place. We would welcome additional safeguards but believe that the most important change would be to ensure the PRA has regards for the FCA objectives.

Lastly, on the boundary of prudential regulation between the FCA and PRA (para 2.57) we agree that a clear framework needs to establish where the boundary lies for both firms and regulators. We believe the focus of the FCA must primarily lie with consumer protection. Any definition which places excessive and resource intensive demands on the FCA, to fulfil its prudential duties for those firms too small for the PRA, will mean the FCA is less likely to achieve its consumer protection goals. Consequently, clarity is needed but also an understanding of the importance that the FCA should be seen primarily as a consumer protection and competition regulator.

Question 5.

In terms of the governance of the PRA, we are very disappointed to note that while the good 'process disciplines' imposed by Parliament on the FSA under FSMA have by and large been carried through into the new regime for the FCA, a number are singularly absent for the PRA. The PRA will have significant prudential powers and these will impact consumers and the economy more widely. It should not be allowed unfettered exercise of discretion without a proper set of public accountability checks and balances. We see no reason why the PRA should not, for example, be required to consult the Financial Services Consumer Panel on matters affecting consumers (for example, appropriate protection of insurance policy holders). We also believe the PRA should be required to consult publicly, as the FSA does, on its general policy approach to the discharge of its functions.

We are keen to ensure a proper 'balance of power' between the constituent parts of the new regime, and note the experience of Dutch regulators in this regard. Their advice is to ensure that the two parts of any 'twin peaks' system have equal weight. To this end we are very concerned by the proposed PRA veto power over the FPC. Whether this is used or not, it shifts the power balance in the new system and will affect regulatory culture and status. It could also lead to the FPC not acting effectively in the interests of consumers.

We do not believe a veto is necessary in view of the other safeguards built into the new system to ensure co-ordination and appropriate stability. The FCA's own strategic objective – protecting and enhancing confidence in the UK's financial system – means the FCA could be 'ultra vires'[1] if it takes action that threatens confidence in UK markets or major UK institutions or threatens their stability. There are also provisions in place to ensure effective consultation between the PRA and the FCA before key decisions are made. Thus, there is no need for such a veto any way.

PRA culture

It is also critical that the right culture is installed within the future PRA. For a fuller answer on culture change see our response to Q7. Financial services regulators, whether PRA or FCA will need to have the level of skills and experience necessary to move away from a 'box ticking' reactive approach to a more proactive preventative modus operandi. This will require higher level skills, analysis, stakeholder engagement and sound judgement.

To fully inform any future judgement led approach for the PCA it is key for the new PCA Board to set the organisation's appetite for risk. We agree the new regime should not be a zero failure regime. Mistakes are always made and avoiding a blame culture will encourage regulatory staff to take responsibility and exercise their powers fully rather than holding back. But this needs careful stakeholder engagement and handling skills.

In response to para 2.63, we would reiterate the importance of alerting consumers to a failing or risky bank. We believe if there are structural concerns about its viability consumers should be made aware. It simply is not viable to allow further deposits or investments if that money is endangered. The regulatory system should aim to prevent such occurrences in the first place.

Question 6 – FCA Objectives

What is a consumer?

We have a number of significant concerns over the general framework of objectives and principles for the FCA that is embodied in the current version of the Bill. But before discussing these concerns it is necessary to determine who the FCA is there to protect. The draft Bill falls into the same trap as FSMA in defining 'consumer' too widely. The definition includes not only ordinary consumers but also commercial entities whose professional role includes the purchase of, or dealing in, financial products. Because the definition is so wide and includes professionals there has been a need for clauses such as the general principle that 'consumers should take responsibility for their own decisions' 3B (1)(c). We have strong objections to this given that individual and SME consumers lack the knowledge, experience and expertise to fully do so in many financial services markets.

We believe the definition of consumer in 1 (c)(3) of Clause 5 is far too broad. We see no reason why the definition of a consumer in financial services legislation should differ from those widely used in other UK legislation for example, as under Ofgem or Ofcom's remit. A potential definition of a consumer could be drawn from the current draft of the European Commission's Consumer Rights Directive where consumer means 'any natural person who [in purchasing financial products and services] is acting for purposes which are outside his trade, business, craft or profession'.

[1] Acting without proper authority or rules.

Such an approach would help the new FCA focus its consumer protection responsibilities on the right consumers and the right markets. It would also allow the FCA (which will have an ambitious remit) to have clearer focus on its other main jobs, namely to ensure that wholesale financial markets function with integrity and to act as an effective micro-prudential regulator for the 26,000 or so firms for whom it will have prudential responsibility.

The FCA strategic objective

First, the wording of the single strategic objective is not strong enough to give the new FCA appropriate guidance as to its regulatory approach. We would like the FCA's strategic objective in 1B (2) to be:

'protecting and enhancing sustained confidence in the UK financial system'.

Without this amendment there is a significant risk that the new regulator will promote policies that promote short term confidence even where this is not properly grounded. Customers of Equitable Life and Northern Rock no doubt had plenty of confidence in the system until it was too late. Adding the word 'sustained' will ensure the regulator never has the imperative to hide problems in the face of a drain of confidence. Sustained confidence also places equal weight to distant events thus reinforcing the importance of 'horizon scanning'. The addition of sustained will ensure unambiguously that the regulator must think longer term and ensure it sees off problems before they become serious and that it is never tempted to hide problems to ensure confidence in the present.

A competition objective

We also feel strongly that promoting effective competition needs to be more central in the objectives of the new regime as competition will be more effective at delivering many consumer benefits, in the longer term, than regulation. Yet, we believe some amendments are needed to the current definition of competition.

We recommend clause 1B (4) of the Bill be amended to read

'The FCA must, so far as is REASONABLY compatible with its strategic and operational objectives, discharge its general functions in a way which promotes EFFECTIVE competition'

Addition of the word 'reasonably' provides the FCA with more discretion about how to trade-off its various objectives. The term 'effective competition' is generally preferred over 'competition' in other statutory frameworks because it is a broader concept, recognising the fact that for competition to work properly for consumers the demand side as well as the supply side of the market needs to work well. In financial services complexity, intangibility of products, information asymmetries, behavioural biases and lengthy terms of many products present significant challenges to a properly functioning demand side, and where these problems persist then regulatory interventions beyond enhancing competition to protect consumers will remain necessary.

Have regards to

There is a need for additional 'have regards to'. With the Bill as drafted, it would be possible for the FCA to proceed on the basis of advancing one of the two operational objectives not expressly concerned with consumer protection – promoting efficiency and choice in the market for financial services; and protecting and enhancing the integrity of the UK financial system. But with either of these, there needs to be a clear guide to ensure these are accomplished with the consumer interest in mind. Most notably reasonable access to financial services, fairness in the way markets operate and value for money must be ensured.

Thus, we think there is a need to add a 'have regards to' that requires the FCA to take on board in any of its activities 'the longer term interest of consumers'. This could be included in 1(b) (5) proposed within Clause 5 of the Bill.

The new regime must adequately protect all consumers

Consumers are not homogenous in their needs for products and services nor in how they are able to access, use and understand financial services and products. People can face barriers in the market place for a variety of reasons both temporary and permanent. The regulator must have regards for these differences.

This should involve looking not only at individuals' characteristics and other risk factors which might put consumers at a disadvantage but also the nature of markets and situations in which consumers find themselves, and the extent to which some services are more essential than others. We also need to consider the effects of multiple disadvantages.

We strongly believe that there is a need for the FCA to have an additional 'have regard to' to take account of the differences between consumers. We suggest that parts of OFCOM's objectives would be suitable for this purpose:

'OFCOM must also have regard, in performing those duties, to such of the following as appear to them to be relevant in the circumstances –

(h) the vulnerability [of those] whose circumstances appear to OFCOM to put them in need of special protection

(i) the needs of persons with disabilities, of the elderly and of those on low incomes

(l) the different interests of persons in the different parts of the United Kingdom, of the different ethnic communities within the United Kingdom and of persons living in rural and in urban areas'

Question 7

We agree with the 'judgement based' regulatory approach as set out in the White Paper, and as set out in greater detail by the FSA in its *FCA: Approach to Regulation* document. The FCA paper sets out a clear case why stronger, more pro-active regulation is needed and its intention to intervene earlier, more strongly and more robustly. Fundamentally, it recognises financial markets are inherently poor at guaranteeing consumer value even where there is apparent strong competition since behavioural biases mean firms are incentivised to produce complex and misleading products.

Are we savvy consumers?

It is too easy, in this context, to make unrealistic assumptions about consumers' level of knowledge and financial sophistication. Consumers in UK are among those most likely to describe themselves as 'knowledgeable' in theoretical market research polls but research show that they are among those least likely to know their rights across a range of markets Meanwhile levels of financial capability, functional literacy and numeracy remain extremely poor. It is estimated that over 5.2 million UK adults lack the basic day to day competencies of functional literacy and 6.8 million lack functional numeracy. More than 20 per cent of adults, asked to choose between receiving £30 or 10 per cent of £350, opt for the lower figure. A recent FSA survey asked the question: 'if the inflation rate is 5 per cent and the interest rate you get on your savings is 3 per cent, will your savings be worth as much in a year's time?' – one in five gave the wrong answer .

Compounding this lack of basic understanding is the complex nature of many financial product contracts – despite years of effort by regulators to improve disclosure.

For example, the consumer document from a major high street bank for a personal loan requires degree level education to understand; the standard text describing a Payment Protection Insurance (PPI) product requires PhD level education to comprehend. It takes 55 minutes just to read a standard consumer credit agreement, let alone understand it.

It would therefore be unreasonable to argue that where a consumer has failed to fully read through and fully understand a complete set of terms and conditions they should automatically receive a lower level of protection. Problems of this kind were for example behind the recent PPI scandal. Thus, it is clear a new approach is needed.

Culture change required to deliver new proactive regulatory approach

Quite clearly however, judgements require a different skill set to a compliance-led Conduct of Business style approach to regulation. This will need more staff with wider skills including a better comprehension of consumer behaviour.

We commend the recent steps taken by the FSA to enhance the calibre and competence of regulatory staff and would like to see this developed further. It is important that further experience is not lost in the transfer to the new regime but equally there is scope and significant potential benefit to be gained from injections of new talent, including more people with consumer policy and research expertise and more practitioner expertise.

It is worth noting that any regulatory structure can be made to work given the right powers, tools, wider stakeholder engagement, and culture. What is crucial however is getting the statutory framework right, particularly in terms of statutory objectives, as this drives regulatory behaviour and approach.

Getting governance structures right, with an appropriate mix of independent directors with the confidence, style and ability to get on top of complex issues and constructively challenge in an effective way, will be crucial. Consumer interests should be effectively represented at Board level, as well as in the other branches of the regulatory regime.

Transparency

We believe changes are needed to the legislation as set out in the draft Bill to realise the new proactive regulatory approach. While regulatory principles 5 and 6 set out a new approach to transparency and openness, other parts of the FCA's proposed powers would, we believe, undermine a new proactive and transparent approach to regulation. The regulatory principles applied to PRA and FCA are:

- 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

The disclosure is still limited and it is unusual for principles to be qualified by 'as appropriate' and 'as possible'. S.348 limits the regulator's ability to publish firm specific information in their regulatory duties without the consent of the firm affected. The current S.349 under FSMA still provides for disclosure of confidential information for the purpose of facilitating the carrying out of a public function. The new regulatory principles might bolster the case for regulations under this provision. However, while S.348 remains it is unlikely that the interpretation will change.

We believe that the FSA should be given the power to name firms at the commencement of the disciplinary process where it has been established that the firm has a case to answer, a presumption that a warning notice will be published and finally earlier publication of decision notices *once* the decision has been made rather than after all appeals have been exhausted. The proposed changes stop short of this, are qualified, and are likely to be subject to the same legal arguments from industry.

We call for amendments to S.348 and the definition of '*confidential information'* to allow the new regulatory principles to empower the regulator to use transparency as a regulatory tool.

Why we need greater transparency

There are strong justifications for a more transparent approach which would deliver stronger incentives for firms to behave responsibly, send helpful signals to other market participants about what is and is not acceptable, provide useful information to consumers and consumer advocates and advisers, and enhance public trust in the regulatory process. We believe amendment to FSMA should allow the FCA, like Ofgem, OFCOM and the Advertising Standards Authority (ASA), to publish the initiation of enforcement proceedings. This would allow it to demonstrate it is delivering on its statutory duty on 'enhancing *sustained* confidence in the UK financial system'.

In energy markets, Ofgem announces on its website when it is investigating firms for breaches to the licence.[2] It also openly reports after nine months what has happened to the investigation. Equally, the ASA publishes on its website when a complaint has been made that they are investigating. OFCOM also announces which firms it is investigating. We see no reason why financial services firms should be granted greater dispensation from public disclosure as would still be the case under the draft Bill.

Such an approach would allow the regulator to better deliver its operational objective 'appropriate consumer protection' and comply with the draft regulatory principles 5 '*openness and disclosure'* and 6 on '*transparency'*.

Firms may argue that financial firms are sensitive to market fluctuations if they are unfairly accused, but the reality is the regulatory resources are so stretched it is extremely unlikely the FCA will pursue speculative cases. Indeed, the danger remains that enforcement action remains so difficult to prove and so resource intensive that firms will still escape enforcement action. If we are to move to a '*judgement based regulatory* approach' then the future regulator must have sufficient, easy to use tools, including publicity, to ensure that it keeps markets clean and fair.

Parliament must give the future FCA the regulatory tools to enable enforcement action to be quicker, less costly and less onerous on regulatory resources. Consumers must be made aware of which firms are committed to fair treatment and which are likely to mistreat them. We are aware of the difficulty the FSA has experienced – even with key techniques such as mystery shopping – in gathering sufficient evidence of a robust enough nature to proceed with enforcement action. To support the FCA's new intensive supervisory approach, we favour a change to place financial services enforcement action within a civil rather than a criminal regime, and subject to a balance of probabilities test. This should allow the FCA to accept wider notions of evidence than in the past, and allow enforcement action to be quicker with a lower threshold to prove regulatory breaches. It would be a strong incentive for firms to avoid consumer detriment and 'gaming' the regulator and its enforcement procedure if future enforcement action was quicker, more robust and made public.

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[2] Ofgem, *Enforcement Guidelines on Complaints and Investigations*, 232/07

Question 8

We are happy for the FCA to have a statutory duty placed upon it to require it to investigate and respond to issues of mass detriment from designated consumer bodies in financial services markets. It should also have clear powers to undertake market studies where it does not believe markets are functioning in the consumer interest or where effective competition could be improved. Just as it has the 'duty' under the proposed legislation to promote competition, so the FCA should have the powers to act quickly, decisively and effectively if there are barriers preventing competition from being effective.

In terms of consumer detriment, we believe it is vital that the current arrangements under the 2002 Enterprise Act for super-complaints are extended. Designated consumer bodies should be given the powers to refer issues about financial services as 'super-complaints' direct to the FCA rather than to the OFT as at present. As is currently the case, the FCA should have a commensurate statutory responsibility to investigate and respond to the super-complaint in a timely fashion.

Super-complaints have proved an effective policing and influencing tool for the retail market as organisations such as ourselves, Which? and Citizens Advice have been able to raise cases of significant detriment with the OFT for priority action. We strongly urge these powers to be clear on the face of the Bill. At the moment the draft Bill only refers to '*referral powers'*, including from other bodies funded from the levy – Money Advice Service (MAS) and Financial Ombudsman Service (FOS).

Our super-complaint on cash ISAs, which resulted in the maximum time of transfer being cut to 15 days from 23 days and interest should be paid on every day of the transfer is estimated to have saved consumers up to £14.5 million.[2] Equally, it was a super-complaint from Citizens Advice that eventually lead to PPI compensation. The ability to refer such super-complaints direct to the FCA with its detailed knowledge of the market and its wide range of powers to take any necessary action would improve regulatory efficiency and effectiveness.

The extra 'referral powers' for MAS and FOS are welcome if they find the regulator slow to act, but one would hope the new co-ordination committee as set out in March under FS11/2 should ensure FOS complaints data and MAS intelligence is fed back to the regulator. Thus the powers of referral will be more useful for other, external, bodies.

Question 9

The FCA should have a statutory duty placed upon it to require it to investigate and respond to super-complaints from designated consumer bodies about practices causing consumer detriment in financial services markets. As with the current super-complaint powers, the FCA should respond to any submission with a preferred course of action within 90 days. It should have clear powers to undertake market studies where it does not believe markets are functioning, either following its own investigation or as part of a referral, in the consumer interest or where effective competition could be improved. These powers should replicate the current super-complaint and market study powers the OFT exercises.

We believe if the FCA were to announce an investigation and its results after 90 days this would fit well with its new approach under regulatory principles 5 and 6 to be transparent and more open. We concur with the regulatory approach that better informs consumers if there are systematic issues that the regulator has identified. Any efforts to prevent such crises as the PPI scandal would be welcome. We believe the proposals as they stand would enable that.

Question 10

Just as the FCA has the 'duty' under the proposed legislation to promote competition, so the FCA should have the powers to act quickly, decisively and effectively if there are barriers preventing competition from being effective. Thus, it is important that most powers to resolve poor competition are given to the new regulator including market studies. However, we agree that the powers should not be concurrent and for a fuller market investigation, or more complex technical case under competition law, the FCA could refer to the new Competition and Markets Authority (CMA). We agree once again with the 90 day limit for any response by the CMA. Any investigation presumes some sort of consumer detriment, and resolution should come as quickly as possible.

We are happy with the proposals for the relationship as set out in paras 2.116 to 2.119 concerning the relationship between the future FCA and PRA and CMA with regards the regime for scrutiny of the regulation of financial services.

Consumer Focus response to HM Treasury on the Draft Financial Services Bill

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cml Council of Mortgage Lenders

A new approach to financial regulation: the blueprint for reform

Response by the Council of Mortgage Lenders
to HM Treasury

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. The CML welcomes the opportunity to comment on the HM Treasury (HMT) consultation paper *"A new approach to financial regulation: the blueprint for reform"*, which includes the white paper and draft Bill.

3. The CML has submitted responses to both of the HMT consultations on the proposed regulatory structures and has responded to the Financial Services Authority's (FSA) discussion paper DP 11/1 on product intervention and its Financial Conduct Authority (FCA) FCA approach document.

4. This response, like our previous responses, is based on our experiences with the FSA, in particular our engagement in the Mortgage Market Review (MMR) and in negotiations on specific issues, including Mortgage Payment Protection Insurance and Mortgage Exit Administration Fees. This response has been drafted in consultation with our members. As such, we will limit our response to issues that are of most significance to their mortgage lending and administration activities.

Executive summary

5. We are encouraged that HMT has recognised a number of the issues we raised in our response to the '*Building a stronger system*' consultation earlier this year. However, we still have a number of reservations where we think that the proposals need to be further amended if the effectiveness of the new regulators and the markets they are designed to serve is not to be compromised.

6. The extent of the Financial Policy Committee's (FPC) risk appetite and how it will be determined remains unclear. This will be a driving force in the FPC's policy decisions and, as a result, the day-to-day work of the regulators. But the process by which the FPC will come to its conclusions should be further explained, in particular what checks and balances will be applied. If this is not properly resolved, the FPC could effectively be left in a vacuum, to determine for example what constitutes an 'adverse impact' and how the 'short term' should be defined. This in turn could undermine competitiveness in the mortgage market and stifle innovation.

7. We welcome the amendments to the Prudential Regulation Authority's (PRA) objectives and scope, but continue to have reservations with the practical application of an environment in which there are dual regulators. The white paper does not explicitly outline how the FCA will prudentially regulate firms in its ambit and how arbitrary differences within markets, which may well arise when different prudential regulators assess different firms undertaking the same activity, will be managed.

8. We maintain that the current Panel structure should be strengthened across not only the FCA but also the PRA to ensure practical adherence to the memorandum of understanding on cooperation.

9. We support the FCA's proposed single statutory objective and the enhanced approach to both the promotion of efficiency and choice and the requirement to discharge its functions in a way that promotes competition. We also welcome the inclusion of regulatory principles as well as the proposed controls for product intervention.

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10. But we continue to have concerns with how the new conduct regulator will practically apply its powers. There is a risk of scope creep if the FCA becomes too involved in product pricing. And there is still not enough recognition on the face of the Bill of the broad spectrum of retail consumers, and by inference the distinctions between mortgages that suit different purposes, and the varying levels of protection that they require.

11. We would urge government to give full consideration to the detailed interactions between regulators, their new powers and respective day-to-day duties to avoid unintended detriment to consumers, firms and the mortgage market as a whole; and to make its conclusions clear during passage of the legislation.

Question 1 - Do you have any specific views on the proposals for the FPC as described in paragraphs 2.6 to 2.24 and in Chapters 3 and 4?

12. In our responses to the two previous HMT consultations in July 2010 and February 2011, we confirmed our support for the broad objectives and functions of the FPC. The clarification around the requirement for the FPC to balance its objective of financial stability in a way which is likely to avoid significant adverse effects on the capacity of the financial sector to contribute to the economy is also welcome.

13. However, we do have some continuing concern about how the FPC will determine and communicate what its risk appetite is likely to be, particularly if this is established without due regard to macro-prudential regulators in other jurisdictions. The extent of this risk appetite will clearly drive how and when the FPC deploys the powers proposed in the white paper and draft Bill; and will be a crucial determinant in what effect the policy of the Committee will have on the mortgage market.

14. The two risks outlined in section 9C subparagraph 3 of the draft Bill (systematic risks and unsuitable leverage) will ultimately be determined by the FPC's risk appetite and it will be important for those affected to understand the rationale behind it and be able to make their views known. Otherwise the Committee will have a significant and unchecked power which will have serious consequences for the operation and structure of financial markets, either through stifling competitiveness or inadvertently moving to a 'zero failure' approach.

15. In section 9C subparagraph 4 of the draft Bill it states that the FPC's power can only be exercised in a way that does not have an adverse impact on the financial sector's ability to contribute to economic growth in the *medium* and *long* term. But there is no reference to the short term, or the impact which actions in the short term could have on the medium and long term.

16. Consequently, we think that there needs to be more checks and balances on the FPC. In particular, the statute should spell out how the FPC is to determine and communicate its definition of the key terms such as improved and clearer definitions around what constitutes risk and what is its risk appetite, as well as how it will differentiate between the short, medium and long term and to what extent the FCA can sacrifice the contribution of the financial sector to economic growth.

Question 4 - Do you have any comments on the objectives and scope of the PRA, as described in paragraphs 2.46 to 2.61 and in Chapters 3 and 4?

17. We generally support the objectives and scope of the PRA and welcome the amendments that HMT has made following responses to the February consultation. We maintain that both the PRA and FCA should have a competitiveness objective to ensure that the financial stability objective is discharged proportionately and without harmful consequences. We still have concerns regarding some of the more detailed elements of the PRA's approach, but these are covered in our response to question five below.

Question 5 - Do you have any comments on the detailed arrangements for the PRA described in paragraphs 2.62 to 2.78 and in Chapters 3 and 4?

18. The proposals in the white paper and draft Bill recognise a number of the concerns we raised in our response to the February consultation paper. The primary issues that we have remaining relate to the interaction between regulators, particularly the relationship between the PRA and the FCA, and the impact that this is likely to have on our members.

19. In our previous responses on this issue to date we have highlighted the potential for firms to be placed in a position where they either breach conduct or prudential regulation. While this is a worst case scenario, there are likely to be situations where this will occur, and it may happen relatively frequently as the statutory objectives of the PRA and FCA will take them in different directions.

20. The recent guidance consultation on forbearance and impairment provisions, published by the FSA, is a practical illustration of potentially conflicting regulation and messages to firms. In our response, we highlighted the following points:

- The prudentially focussed paper did not give due recognition to the conduct pressures that firms had been under in recent years to show increased levels of forbearance and treat possession as the last resort.

- Aspects of the FSA's guidance appeared to be moving firms and borrowers away from reaching a mutually agreeable compromise of how to address financial difficulty, towards a position where the firm effectively imposes a forbearance solution on a borrower.

- The FSA warned firms about forbearance that "places [the borrower] in a worse position than they would have been otherwise". But it was unclear whether the FSA is asking firms to consider purely the long-term monetary impact of the forbearance or additional non-monetary aspects. With possession as the last resort and pressure on firms to respond favourably to borrowers' short-term financial difficulties, there is a risk of retrospective regulatory judgements being made with the benefit of hindsight.

- Although much of the prudentially-focussed good and poor practice around individual elements of forbearance is common sense, there are implications for firms' conduct of business. Although not the FSA's intention, interpretations of MCOB 13 may tighten and the timetable to possession in some cases may accelerate.

- The guidance consultation appears to be an early manifestation of the risks in the 'twin peaks' model.

21. Where firms are faced with conflicting regulatory requirements, it is likely that the PRA's regulation will take priority. This is primarily because the PRA will be the lead regulator where firms are dual regulated. The PRA's status is confirmed in paragraph 9 of section 4 of the Bill.

22. This could create arbitrary differences within markets, where some firms are prudentially regulated by the PRA and others by the FCA. For example, non-bank lenders in the mortgage market will be regulated by the FCA for prudential matters and not the PRA. The different objectives of the regulators might well result in different approaches to prudential regulation, given that the purpose of the PRA is to promote the safety and soundness of firms (e.g. to ensure business is carried on prudently and to seek to minimise the adverse effect of a failure on the stability of the UK financial system), whereas the purpose of the FCA is to protect consumers and the market (e.g. failure of firms will not result in consumer detriment). This will ultimately impact on the products and process on offer and how they interact with consumers.

23. We appreciate that the white paper and draft Bill seek to minimise the risk of potential conflicts, by the creation of a statutory duty for the PRA and FCA to cooperate via a memorandum of understanding (MoU). But, the different scope, objectives and approaches is likely to result in

different, and sometimes conflicting, regulation. Equally, the white paper (and the FSA's FCA approach document) focuses on how the FCA will undertake its conduct and market functions, but does not outline clearly how it will prudentially regulate firms. We look for assurances that there will be clarity over how these conflicts will be handled and how appropriate consistency will be achieved during passage of the Bill, whether or not this results in provisions on the face of the statute.

24. Our second ongoing concern relates to the accountability and consultation requirements of the PRA. We welcome the move to extend the current consultation requirements in the Financial Services and Markets Act 2000 (FSMA) to the PRA and to include a statutory duty for the regulator to put in place arrangements for engaging with practitioners. However, the lack of specificity on the detail of these arrangements is a significant concern. Section 2J subparagraph 1 of the draft Bill provides the PRA with broad scope to determine which practitioners it consults, when and in what form. At the very least, we continue to believe that the PRA should have a statutory duty to establish and maintain a practitioner panel.

25. It would be significantly more beneficial if the FCA practitioner panel performed the same standing function for the PRA and with its existing mechanisms and functions maintained. This consistency of approach is particularly important given the potential for conflicting regulation of firms, to monitor the MoU on cooperation and comment on the efficient use of recourses. Having a shared standing committee of this nature, will not be a sign of 'regulatory capture' by the industry, it would merely ensure that practitioners have a formal role in the oversight and accountability arrangements of the regulator. It would also be a route by which practitioners could flag whether the two bodies were inadvertently taking different approaches and thus creating the sort of difficulty to which we refer in the preceding paragraphs.

26. The CML has engaged in discussions with the FSA's practitioner panel regarding its response to this, and the previous HMT consultations, and strongly support its position.

Question 6 - Do you have any views on the FCA's objectives – including its competition remit - as set out in paragraphs 2.80 to 2.90 and in Chapters 3 and 4?

27. We broadly welcome the amendments and clarifications in the white paper following HMT's February consultation. Before we respond to the detail of the FCA's objectives, we believe that that the FCA is likely to be seen as ultimately subordinate to the PRA because of the prudential regulator's right to veto FCA actions. As outlined above, and in paragraph 9 of the explanatory notes, it states that 'the draft Bill establishes the PRA as lead regulator where firms are regulated by both the PRA and the FCA…'

28. This is caveated by stating that the PRA can veto action by the FCA only where it is likely to lead to a disorderly failure of a firm. While these may seem like limited circumstances, they may occur more frequently then anticipated.

29. For example, lenders with a high proportion of tracker mortgages on their books faced prudential difficulties due to the historically low Bank of England base rate in 2009. Some lenders had clauses in their contracts to cap these rates, thereby limiting prudential risks. The FSA took action (both supervisory and through undertakings) to limit the use of such clauses as it had concerns regarding the fairness to consumers of the terms and conditions under the unfair terms in consumer contracts regulations.

30. The terms tend to have a floor below which the interest rate will not fall, no matter how low base rate drops. Alternatively, they may have a clause that allows the firm to amend the rate in, usually undefined, 'exceptional circumstances'.

31. The FSA's primary concern was that these terms were unfair to consumers as they tend not to clearly list the circumstances when they would be implemented or the consequences for the borrower (i.e. how the new, non-tracking rate would be set).

32. However, in 2010 the FSA did not take action against a lender that retrospectively defined the 'exceptional circumstances' under which it could remove the link between its standard variable rate and the Bank of England base rate. It recognised that this was for prudential purposes and effectively overruled the conduct action the FSA had taken with other firms.

33. This decision was taken by the regulator in the context of an individual firm, but the difficulty is how this decision will be made and communicated when the new regulatory structure is implemented.

34. Taking the above example, if firms are aware that ultimate regulatory responsibility lies with the prudential body, their approaches to conduct of business are likely to be influenced as a result.

FCA objectives

35. We welcome the clarifications in the white paper and draft Bill and support the single statutory objective of the FCA. Equally, we broadly support the three operational objectives. We would, however, echo the comments in our response to the February consultation paper, that the regulator should have an appropriate degree of protection for consumers that should reflect a differential approach both between market and retail consumers, but critically between different types of consumer within the retail market also.

36. In developing its Mortgage Market Review (MMR), the FSA has stated that it is not seeking to create a one-size-fits-all approach to mortgage regulation, recognising the differing needs, circumstances and financial capability of consumers. We strongly support this approach and believe that the FCA should apply a differentiated approach between retail consumers wherever possible and should be specifically allowed to do this on the face of the Bill.

37. The enhanced approach to both the promotion of efficiency and choice and the requirement to discharge its functions in a way that promotes competition are positive changes as they will encourage a better understanding of the market dynamics that will be essential to inform the pro-active approach to the FCA (including its new product intervention powers). We also think that it is appropriate that the FCA should be able to make referrals to the Office of Fair Trading (OFT), where it believes that there are structural competition issues that are causing consumer detriment.

38. In order to achieve this, the FCA will be required to look at product pricing to determine if there are any competition issues that it needs to address. But price regulation is not the government's intention for the FCA, nor should examination of product pricing be at the expense of considering other influential factors such as service, innovation and quality.

39. Therefore we strongly believe that the draft Bill should be amended to reflect the government's intention in order to provide clarity around the scope of any new price intervention powers that may be necessary. Once the powers are framed in the legislation, the FCA should provide a clear view to stakeholders on when and how the powers could be employed.

40. The inclusion of the regulatory principles is welcomed; in particular the acknowledgement of consumers being ultimately responsible for their actions. This is an important legal acknowledgement of an essential feature of an efficient market - but one which is lacking from the current framework.

Question 7 - Do you have any views on the proactive regulatory approach of the FCA, detailed in paragraphs 2.91 to 2.110 and in Chapters 3 and 4?

41. The CML's response to the FSA's discussion paper on product intervention (DP 11/1) outlined our views. The key points in the response relate to the uncertainty that product intervention powers can create in the market and the brake on innovation. We suggested that the FSA (and FCA) should review its current regulatory tools to determine if it can achieve the same outputs without requiring specific product intervention powers.

42. In our view the most appropriate tools are the enhanced supervision of firms and some consolidated guidance or rules on what the regulator would consider to be appropriate management structures to govern the product development process.

43. However, we accept that the FCA will have product intervention powers and we welcome the controls that the draft Bill will place on the use of these powers, requiring the regulator to consult on and publish a policy governing the circumstances in which it may make temporary product intervention rules and setting the maximum period of 12 months.

44. For the reasons stated in our previous responses, we are disappointed that HMT is proposing to continue to give the FCA powers to disclose that a warning notice has been issued to a firm to support a more open and transparent regulatory approach. Paragraph 2.108 recognises our concerns that the publication of notices could serve to undermine confidence in financial services, and that it **expects** the FCA to take this into account in setting its policy. **If this is HMT's intention, it would be appropriate to add this requirement to the draft Bill.**

45. Paragraph 2.188 of the white paper and section 24 (6) of schedule 8 of the draft Bill already include restrictions on publishing notices that could undermine consumer interests or market stability; this should be expanded to include confidence in the UK financial system (the FCA's statutory objective).

Question 8 - What are your views on the proposal to allow nominated parties to refer to the FCA issues that may be causing mass detriment?

46. We strongly agree that the Financial Ombudsman Service (FOS) should focus on processing individual complaints on a case-by-case and in doing so it should not seek to set legal precedent or change regulation. The same principles must apply to the formalisation of the wider implications referral process.

47. We agree that the FOS should be able to make referrals to the FCA where it has evidence of large scale detriment with common underlying issues relating to a specific product and/or sales process. The FCA should be required to consult on, and then publish, the circumstances when the FOS can make referrals. Within this control there should be a clear understanding of what constitutes 'large scale detriment'.

48. We would caution against the extension of the power to make referrals to the FCA to include consumer groups. The major concern we have is that such referrals are likely to be based on a partial or incomplete picture of a subset of consumers that have made contact with a specific group. Such referrals, in a worst case scenario, could be reactionary in response to speculative media coverage. The role of the consumer panel within the FCA structure, has been, and should continue to be, adequate in highlighting consumer issues that are of concern. The experience of the OFT with super-complaints will be relevant; and there should be a formal assessment of how that power has been exercised and the value which it has delivered before this power is granted.

49. Finally, given the increasingly significant role of complaints management companies (CMCs) in the market, there is a strong possibility that the move to early intervention more broadly, as well as FOS referrals to the FCA, could create a self-fulfilling process. The actions could trigger the CMCs to cultivate complaints, thereby creating (or enhancing) the exact issue that the FCA is trying to avoid.

Question 9 - What are your views on the proposal to require the FCA to set out its decision on whether a particular issue or product may be causing mass detriment and preferred course of action, and in the case of referrals from nominated parties, to do so within a set period of time?

50. Where the FOS do make referrals to the FCA we agree that it would be beneficial to require the FCA to respond within a set time period.

51. As the FCA's 'preferred course of action' is likely to fall directly on firms we believe that it is appropriate for the FCA to discuss the proposed action with the impacted firms prior to publication. The CML has been involved in two successful examples of this in action in recent years:

- In 2009, the CML, Association of British Insurers, British Bankers' Association and the Building Societies' Association, worked with the FSA to develop an agreed approach to address the regulator's concerns with mortgage payment protection insurance (MPPI).

- Prior to this in 2007 the CML worked with FSA to develop appropriate solutions regarding mortgage exit administration fees (MEAF).

52. By engaging the industry in the solution, it serves to mitigate CMCs involvement in the process and reduces the need for complaints to be considered by the FOS (this was the case for both MPPI and MEAF solutions), whilst achieving change and redress for consumers as appropriate.

Question 10 - Do you have any comments on the competition proposals for the FCA set out in paragraphs 2.111 to 2.119 and in Chapters 3 and 4?

53. We broadly support the requirement of both regulators to have to discharge their requirements in a way that encourages competition. In question 6 above, we outline our concerns for the FCA becoming a 'price regulator' by proxy. We strongly believe that the government should define the FCA's competition powers in a way which ensures that it cannot move into price regulation.

Question 12 - Do you have any comments on the governance, accountability and transparency arrangements proposed for the FCA, as described in paragraphs 2.124 to 2.132 and in Chapters 3 and 4?

54. We believe that the governance, accountability and transparency arrangements proposed for the FCA are broadly appropriate.

55. We strongly support proposals to enhance the FCA's accountability to government and parliament. There may be a case for looking at further ways to enhance accountability of the regulator.

56. The current proposals seek to ensure accountability via appointments to the FCA's board, reports to HMT on regulatory failures and for an independent review of the regulator's efficiency and effectiveness. Given that the FCA's actions can directly impact on broader government policies, (for example restrictions on mortgage lending could have a dramatic impact on the government's housing policy), we believe that it is appropriate for the FCA to have to consider the potential impacts of its actions on all aspects of government policy and to set out the outcome of that consideration.

57. This accountability could be limited to rule changes, or other actions, that would have sectoral or market wide impact.

Question 13 - Do you have any comments on the general coordination arrangements for the PRA and FCA described in paragraphs 2.138 to 2.149 and in Chapters 3 and 4?

58. We agree with HMT that beyond the primary function of authorisations, it would be very difficult for the legislation to prescribe how the regulators coordinate. Consequently, the requirements for both regulators to agree to an MoU outlining how they will coordinate, and to report on how the MoU is working, at least annually, is the most appropriate tool.

59. There may be other means within the broader accountability tools created in the draft Bill that could encourage better cooperation and coordination. For example, part of the function of the practitioner panel (currently only required for the FCA) could be to review the effectiveness of the MoU in delivering cooperation between the regulators and how that is benefiting firms. This, in our view, is a further good reason for a single practitioner panel that spans both the FCA and the PRA.

60. We would also welcome greater clarification on how the regulators will be coordinated in EU level discussions – both between themselves and with regulators in other jurisdictions. It is vital that the UK has a coherent, consistent UK voice in international discussions at a time when changes to European legislation, which would impact mortgage lending and administration in the UK, are being debated.

Question 14 - Do you have any views on the detail of specific regulatory processes involving the PRA and FCA, as described in paragraphs 2.150 to 2.195 and in Chapters 3 and 4?

61. As there are several issues covered in this section of the paper, we respond to the sections relevant to CML members below.

Authorisation

62. We support the proposed arrangements in the draft Bill for a single authorisation process, with the PRA being responsible for dual regulated firms. This is a good example of appropriate use of joint resources. We would encourage such practices to be used as broadly as possible.

Variation and removal of permissions

63. Given its importance we agree that the consultation process between the regulators on the variation and removal permissions should be included in the MoU. We also believe that there is merit in enabling a firm to retain its permissions when it is not active in a particular market but may wish to re-enter, provided that fees and regulatory responsibilities associated with that permission are maintained.

Approved persons

64. We agree that those with significant influence functions should, where appropriate, be subject to standards and sanctions from both the PRA and FCA.

Mutuals

65. We support HMT's proposals for both regulators to include specific analysis of the impact on mutuals in any cost-benefit analysis.

Rule-making and rule waivers

66. We strongly support the need for the PRA and the FCA to coordinate when drafting rules to ensure that compliance with one regulator's rules does not result in non-compliance with the other's, as outlined in paragraph 2.169 of the white paper. This must be a central tenet of the MoU between the regulators, and should be subject to monitoring by HMT and the practitioner panel.

Supervision of financial groups

67. We agree that there needs to be close cooperation between the FCA and the PRA when supervising financial groups. Equally, as there are many different products and processes captured by the FCA, there must be clear lines of communication within the regulator to ensure a consistent approach to supervision. This is particularly important given the new proactive approach of the regulator.

68. There also needs to be clarity on whether financial groups will have a single prudential regulator. It may cause some confusion if subsidiaries are prudentially regulated by the FCA, where as the core elements of the group are under the auspices of the PRA. We think that it should be determined by the treasury processes within groups. As most will have a single treasury function, they should have a single prudential regulator.

Unregulated holding companies

69. We agree that these powers need to be clearly outlined and should be used sparingly. If there is a suggestion that un-regulated investors, such as hedge funds, could be captured it would cause significant detriment to the UK's competitiveness.

70. HMT is currently considering the appropriate controls that should be in place to protect consumers where mortgage books are sold to unregulated firms. Our view is that as the purpose of this regulation is to protect consumers, the focus of any requirements should be on the mortgage administrators – which are required to be in place in such circumstances and are regulated by the FSA. This ensures that the investor is not directly regulated but the consumers benefit from regulatory protections.

71. The new regulatory structure should avoid capturing investors by employing a similar approach to conduct regulation where the beneficial owner is not regulated.

Enforcement

72. We agree that enforcement should continue to be an active deterrent to firms and welcome the confirmation that although the PRA will have the same powers as the FCA, they are likely to be used only rarely. We think that this is the correct approach for the prudential regulator.

73. Equally, we welcome the safeguard outlined in paragraph 2.188 that limits the circumstances when the FCA or the PRA would publish a warning notice. As discussed in our response to question 7 above, we believe that the exemption in paragraph 24(6) of schedule 8 should be extended to include a reference to undermining confidence in the UK's financial sector, reflecting the FCA's statutory objective.

Question 15 - Do you have any comments on the proposals for the FSCS and FOS set out in paragraphs 2.196 to 2.204 and in Chapters 3 and 4?

74. We outline our concerns regarding the proposed arrangements for referrals by the FOS to the FCA and the consideration by the regulator in question 9 above. The other significant proposal in the white paper is for all decisions by Ombudsman to be published. We believe that is likely to create a legal precedent and interpret regulation. We continue to support the primary purpose of the FOS to provide independent adjudication on individual disputes. It should avoid becoming a quasi regulator or legal body. For this reason we caution against the publication of Ombudsman decisions without adequate controls.

Contact

75. If you have any comments or queries on this response, please contact Matt Smith
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7 September 2011