CAPITA

The regulated firms in The Capita Group (Capita) welcome the opportunity to comment on your consultation paper "A new approach to financial regulation: judgement, focus and stability".

We have responded to the questions that have an impact on Capita and have highlighted some areas where we feel that more clarity is required.

Q1 The Bank of England and Financial Policy Committee (FPC)

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

   We think that the FPC should be required to take into account the statutory objectives of the other regulatory authorities. We accept that there is a balance to be drawn between the FPC having a clear transparent objective and having excessive constraints put upon it. However, by requiring the FPC to give consideration to the statutory objectives of the PRA and CPMA it will ensure a coherent regulatory approach.

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

   As stated above, we think the FPC should have regard to the statutory objectives of other regulatory bodies and wider socio-economic and fiscal considerations.

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

   We believe that these factors should be prescribed in primary legislation at the outset to provide absolute clarity of responsibilities and objectives.

Prudential regulation authority (PRA)

4. The Government welcomes respondents' views on:

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

     Yes, co-operation between the three new bodies is crucial to the success of the new regulatory framework. Prudential issues can have an impact on consumers just as conduct of business issues can impact on a firm prudentially and so it is essential that each authority has regard to the primary objectives of the others.

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

     Yes, we support the retention of the principles of good regulation. These should ensure that the process is not unduly burdensome and ensure a level playing field for all regulated firms, irrespective of whether they are regulated by the PRA or the CPMA.

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

     We acknowledge the Government's concern regarding the case for making global competitiveness and innovation in financial services part of the responsibility of a regulator charged with ensuring the safety and soundness of risk-taking financial. However, we do not think this justifies taking a sceptical view of all innovation: there is a balance to be drawn between good and bad innovation in the financial services sector. For example, we believe that the growth in outsourcing in the financial sector is a key innovation that has improved not just productivity, but also improved outcomes for firms whilst providing benefits to consumers.

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

Yes – the PRA should observe the need for proportionality in its actions by properly balancing the interests of the industry and the general public.

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

   We prefer an integrated model. Capita is an outsourced administration provider to some of the largest insurers in the UK. These insurers will be regulated by the PRA whilst we will be regulated by the CPMA, so we strongly support a streamlined integrated model which provides consistency, procedural efficiency and cost saving whilst avoiding duplication, overlap and a lack of certainty.

   As far as possible, an integrated approach should extend to requests for data, supervisory visits and fee invoicing.

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

   We are in favour of a judgement focused approach to supervision for the PRA and CPMA, however we are uncertain as to how the terms 'risk-based, judgement-focussed' will be reflected in reality. We are concerned, that this could turn in to systematic second guessing the decisions made by regulated firms.

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

   Yes, we believe that safeguards on the PRA's rule-making function are required, in particular that it must be subject to statutory consultation process and must continue to involve the industry. Such a process gives early warning of intent to firms, and provides for comment and challenge by the industry. We also believe that the requirement to produce cost-benefit analysis must be retained – and indeed strengthened - as an integral part of the rule-making process.

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

   We value the current statutory process that requires consultation and cost benefit analysis prior to the introduction of new rules and would not support their removal in any attempt to streamline the rule making process.

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

   We think that the various measures outlined are sound and will ensure that the PRA operates in a transparent, independent and accountable manner.

<u>Consumer protection and markets authority (CPMA)</u>

10. The Government welcomes respondents' views on:

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

      Yes, as set out in our response to Q4, co-operation between the three new bodies is crucial to the success of the new regulatory framework and therefore each authority should have regard to the primary objectives of the others.

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

CAPITA

Yes, we support the retention of the principles of good regulation. These will ensure that the process is not unduly burdensome and that there is a level playing field for all regulated firms, irrespective of whether they are regulated by the PRA or the CPMA.

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

  For the reasons stated in our response to Q4, we think the CPMA should have regard to innovation and the competitiveness of the UK financial services sector. In particular, we think it's important for CPMA and PRA to take these into account when they are involved in the negotiation of EU wide regulations and when proposing any requirements that are super equivalent to minimum directive requirements.

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

  Yes, the CPMA should observe the need for proportionality in its actions by properly balancing the interests of the industry and the general public.

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

Yes, the accountability mechanisms appear to be adequate though subject to further detail, particularly in respect of the CPMA's working relationships with the PRA in the Memorandum of Understanding. We strongly support the proposals that require the PRA and CPMA to work together where both authorities have a supervisory interest. This will be particularly important in terms of groups subject to regulation by PRA and CPMA and where PRA firms have outsourced some of their functions to CPMA firms.

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

As at present, these panels should comprise a wide cross-section of industry practitioners who are able to provide external scrutiny and challenge.

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

We agree with this proposal.

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

We would have no objection to any of the models proposed, however we do not agree with any model that would require the cross-subsidy between different classes of levy payer.

<u>Markets and infrastructure</u>

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

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

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

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

We strongly believe that the UK Listing Authority's responsibilities should remain within the scope of the CPMA. A single authority should be responsible for the oversight of both the primary and secondary markets which are intimately connected and which require a joined up approach.

A single authority would also be in a better position to provide support and protection for London as a financial centre which is crucial to maintaining London's attractiveness as a location for business.

In Europe there is a crucially important role for the CPMA at the ESMA. This will require the CPMA to have an intimate knowledge of the primary markets, secondary markets and clearing and settlement which we believe will be weakened if responsibility for each of these areas is divided.

We acknowledge that we in the industry have an important role, working with the CPMA and the European Commission to help them better understand issuer requirements. This will ensure we achieve the right outcomes for UK companies and investors. In our view, this is achieved best by a strong single body with which we can work, therefore avoiding the various co-ordination issues that would arise should these responsibilities be split.

Crisis management

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

The arrangements seem reasonable bearing in mine the need for flexibility and adaptability to meet any crises that presents itself. However, where discretionary tools are available, care should be taken to use them in a prudent manner and only in the context that these powers were originally granted.

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

There should be proper public consultation to allow consideration of the details of any of the changes given as examples of powers that would heighten supervision. In particular, the proposals that give additional powers to the regulator in respect of unregulated entities such as holding companies in the group structure of a failing firm, the OIVOP power changes and any additional powers to enhance the CPMA's ability to provide effective consumer protection.

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

As the SRR is aimed at banks and building societies we have no comments to make.

Impact assessment

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

We have no comments to make.

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Financial Regulation Strategy
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21 September 2010

Dear Financial Regulation Strategy Team

CONSULTATION: A NEW APPROACH TO FINANCIAL REGULATION

I write as an individual with some experience of the UK regulatory environment, having served as a consultant to a variety of regulators and regulated bodies (see www.simoncarne.com).

I attach my comments on several of the questions raised by the recent consultation paper on financial regulation. I have addressed questions 1-10 and 17-18.

Yours sincerely

Simon Carne

CONSULTATION RESPONSE: A NEW APPROACH TO FINANCIAL REGULATION

1 Secondary factors or a single unconstrained objective

I suggest that the objectives of the Financial Policy Committee need to be as clear and focussed as possible. It is vital that, when unforeseen events arise, the actions taken by the FPC are not obstructed by the legislative requirement to focus on other priorities and factors simply because those other factors were anticipated. The anticipated factors may turn out to be less important than – or even in conflict with – the issues that are at the centre of the threats that actually materialise.

I am not arguing that it is *always* wrong to have multiple duties. A good example where the creation of multiple duties seems to work well is the regulation of utility supply. My analysis differentiates between those regulators which are created in order to avoid a negative outcome (such as the FPC) and those which are created to enhance a positive one (such as those of the utility regulators which exist to ensure the supply of essential services, available to all and at a reasonable price, etc).

I realise that the language I have used ("avoiding financial instability") leaves room for the counter-argument that the goal of the FPC can be re-expressed as a positive one: to enhance financial stability. But I submit that that would be to miss the point. The legislation could, of course, define "financial stability" with a set of positive attributes (or secondary factors) to be pursued. But that would simply achieve the pursuit of those factors that were anticipated in advance. If the FPC is to avoid (or minimise) instability, the legislation must be framed in that way, ie with a single, clear, focussed, ***negative*** objective.

Paragraph 2.29 of the consultation paper raises the question of a need to "balanc[e] carefully the simplicity of a single primary statutory objective against the need for clarity and transparency around the factors that a public body should take into account in considering how to pursue its objective." I think that, in this particular case, it a false dichotomy. There is no balancing act here. Having a single duty is not in conflict with "clarity and transparency". The single duty must, indeed, be clear and transparent. But if the goal of the FPC is to avoid financial instability, the Committee needs to take action against each and every factor which might jeopardise the system's stability and not just those which the legislators were clever enough to foresee.

2-3 What should be the secondary factors and should they be objectives or "have regards"?

In view of my answer to Question 1, these two questions fall away.

4 The Prudential Regulation Authority (PRA)

I address each of the four bullet points separately.

• 4.1 Having regard to the primary objectives of the FPC and the CPMA

I think it is pretty clear-cut that the three bodies need to be pulling in the same direction and not taking actions which (even inadvertently) obstruct each other. But, for the very practical reasons I set out below, this is ***not*** achieved by making the PRA have regard to the primary objectives of the FPC.

If the PRA is required to "have regard to" the primary objectives of the FPC, this means that the PRA will have to explain in its pronouncements how it has addressed those objectives. There may be times when the PRA doesn't agree with the FPC – perhaps unwittingly because the PRA opines on a point before the FPC has thought about it, but there may be times when the PRA addresses a topic before the FPC has considered it. Giving two bodies a statutory duty to consider the same issues is more likely to foment conflict, not eliminate it.

The solution lies in paragraph 2.32 of the consultation paper which says that the FPC will have the powers (a) to "give directions" to the PRA and (b) to "make recommendations" to the PRA. I infer that the PRA will, therefore, be under a duty (a) to comply with any directions that are given by the FPC and (b) to consider (or "have regard to") any recommendations of the FPC. These two legislative conditions should be sufficient to ensure that the PRA and the FPC do not push in opposite directions.

For the avoidance of any doubt, my submission is that:

- the FPC should take precedence over the PRA; and

- the PRA should do what the FPC "directs" it to do and consider/have regard to anything the FPC "recommends" it to do; but

- the PRA should not have a statutory duty to "have regard to" the FPC's primary objectives, because that would then force the PRA to opine publicly on matters which the FPC had the primary responsibility for.

• 4.2 Retaining principles for good regulation and good regulatory practice from the FSMA
I support the principles of good regulation set out by the previous government and I think that regulators should adopt them. I am, however, somewhat sceptical of the need to embed them in legislation.

To put it a little bluntly, if the people chosen to be members of the PRA do not realise for themselves that they should, for example, aim to use the Authority's resources in the most efficient and economic way, they are probably not the right people for the job. Making it a legislative obligation to think about efficiency and economy is unlikely to remedy a defective mindset if it turns out that people are appointed who do not naturally think in these terms. I think the same point can be made for the two other factors articulated in paragraph 3.10 of the consultation paper (proportionality and the responsibilities of those being regulated).

Whilst I don't consider this issue to be as pressing or as problematic as the others which I address in this submission – especially my responses above to questions 1 and 4.1 – it seems to me that, if the general direction of travel of this government is towards making individuals in society take more responsibility for their actions and not rely on others to make rules for them, it might be appropriate to set an example with the legislation governing individuals who sit on regulatory bodies.

• 4.3 Retaining the FSMA requirements relating to innovation and competitiveness
This question attracts different considerations from the previous one. For the reasons below, I think these requirements should be retained.

The key feature of this issue is that innovation and competitiveness have the capacity to work ***both for and against*** the aims of prudential regulation. In the long run, an effective financial services industry depends on its competitiveness and innovation, but there will be many circumstances in which the short-term consequences of a prudent approach, viewed in isolation, may be to damage competitiveness and/or innovation.

If the legislation sets a primary objective for the PRA of a prudent financial system, without expressly acknowledging the need to allow for competitiveness or innovation, there is a real danger that the short term decisions will tend to lean too heavily towards prudence at the expense of competeveness and innovation. Since the long term is inevitably the result of a series of short terms, the long term objective may never be achieved.

I recognise that there is a counter-argument, as follows: if the members of the authority are well-chosen, they will recognise this argument and allow for it. But I think it would be unwise for the legislation not to recognise the inherent potential for conflict between prudence on the one hand and competitiveness and innovation on the other and make an express allowance for the PRA to pay attention to these two goals. Such a legislative acknowledgement of the point would also remove the risk of judicial review in cases where the PRA makes such an allowance.

• 4.4 Additional public interest considerations
I am not aware of any additional considerations at the present time.

5 Making each authority be responsible for all decisions within their remit
I think the model outlined in the consultation paper is appropriate.

The basic premise underlying the decision to separate out the PRA from the CPMA is that prudential regulation and conduct of business regulation require different approaches and cultures – combining them in the same organisation is difficult (articulated in paragraph 1.20 of the consultation paper). The logic of the separation would be undermined, and perhaps totally frustrated, if the decision-making did not fall within each of the separated bodies.

The model outlined in paragraph 3.16 of the consultation paper is a complicated one and it will require great care to make it work. But, for the reason stated immediately above, I think the effort required to achieve this outweighs the disadvantages of the alternative.

6-8 Delivering a more risk-based, judgement-focussed approach to supervision
The history of regulation suggests that achieving a risk-based and/or judgement-focussed approach is extraordinarily difficult. No matter how good the initial intentions might be, "events" intervene which tend to push regulators towards a more prescriptive approach.

One of the most popular phrases after any adverse incident is "we must ensure this never happens again". But a truly risk-based approach suggests that we should do no more than ensure that this ***probably*** never happens again.

If the government is genuinely committed to a more risk-based, judgement focussed approach to supervision, I think more analysis is needed than is revealed by paragraphs 3.17-3.23 of the current consultation paper.

Take, for example, the proposal (in paragraph 3.21 of the consultation paper) that rule-making will be a function of the PRA board and cannot be delegated to a sub-committee or to members of the executive. This is an interesting idea which is presumably designed to ensure that rules do not proliferate or become the plaything of an overly administrative mindset that might be thought to exist amongst the staff of a regulatory body.

But the effect of a such a requirement is that rules will always be made in the environment of a "committee meeting" which is a very different decision-making environment from executive decision-making. It also needs to be stressed that "committee environment", in this context, is not the same as a parliamentary committee.

This whole issue goes right to the heart of the effectiveness of the new (prudential) regulatory regime. It is much more complex than the consultation paper seems to recognise and needs more thought than has so far been disclosed. This need not be a lengthy or costly process, but it is an essential one.

9 Transparency, operational independence and accountability of the PRA
I have nothing to add to the proposals at the present time, but they may need to be re-visited and re-checked once decision-making processes have been thought through (see my responses 6-8 above).

10 The Consumer Protection and Markets Authority (CPMA)
My response to question 10 largely follows my response to the corresponding questions for the PRA:

- *Have regard to the primary objectives of the FPC and the PRA:* As discussed above, I think the three bodies need to be pulling in the same direction and not taking actions which obstruct each other. But I don't think this is achieved through the mechanism of a legislative requirement to "have regard" to the objectives of other bodies. As discussed above in my answer 4.1, if two or more bodies must, by law, have regard to the same objective(s), each of those bodies will have to explain in its pronouncements how it has addressed the objective(s). There may be times when the bodies don't agree with each other, even if only unwittingly. Giving the FPC, PRA and CPMA a statutory duty to consider the same issue(s) is more likely to foment conflict than to eliminate it.

In the case of the PRA, I suggested that it was sufficient that the FPC will have the power to give directions, and to make recommendations, to the PRA. There would, therefore, be no need for the PRA to consider from first principles any of the FPC's primary objectives: the PRA would only need to consider the directions and/or recommendations handed down to it from the FPC.

If it is not appropriate to adopt the same mechanism of "directions" and "recommendations" for the CPMA, some other construct may be necessary. One possibility may simply be for the CPMA to ***have regard to decisions taken, and pronouncements made***, by the other two bodies. The effect of this would be to put the CPMA in third place, so to speak, behind the other two bodies, on those particular issues. The government may want to consider whether that is the right ranking and adjust the proposal accordingly if a different priority ranking is preferred. The central point is that the three bodies should not all have to address the same objectives from first principles, with the potential for public disagreement.

- *Retaining principles for good regulation and good regulatory practice from the FSMA:* Please see my answer 4.2 above, which applies equally here. In brief, I think that regulators should adopt the principles of good regulation, but I don't believe that expressing them in legislation is the right approach to take.

- *Retaining the FSMA requirements relating to innovation and competitiveness:* I think these requirements should be retained. My reasons follow from my response 4.3 above.

  In the long run, an effective financial services industry depends on its competitiveness and innovation, but there will be many circumstances in which the short-term consequences of consumer protection, viewed in isolation, may be to damage competitiveness and/or innovation. Whilst one would expect that protection of individual consumers would normally need to prevail, there is a risk that, if the legislation sets a primary objective for the CPMA of a consumer protection, without expressly acknowledging the need to allow for competitiveness or innovation, the short term decisions will prevent the long term objective from being achieved.

- *Additional public interest considerations:* I have none to suggest at the present time.

Questions 11-16
I have no comment to make at the present time in response to questions 11 to 16.

17-18 Merging the UKLA, the FRC and perhaps other bodies under BIS
If the UK Listing Authority is to be merged with the Financial Reporting Council (and/or any other bodies), I would suggest that thought is needed regarding the cultural suitability of such a merger. I note that the consultation paper recognises the desirability of separating out prudential regulation from conduct of business regulation, precisely because the cultures of the two regulators need to be rather different.

I am not currently in a position to give a definitive answer on this, but it seems to me that a similar point may apply here and I think the issue should be examined further in that light. In particular, I note that the consultation paper describes the proposal as creating a "companies regulator", but the FRC is not really a regulator of companies: it is primarily a regulator of *professions and professional activity*, viz accounting (including auditing) and actuarial work. That may work against a cultural fit with the UKLA.

Questions 19-22
I have no comment to make at the present time in response to questions 19 to 22.

4 November 2010

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

CFA UK represents more than 9,000 investment professionals working across the financial sector. For advocacy purposes, these members are represented by committees that consider proposals relating to professional standards and market practices. The committee's preference is to base responses – in part at least – on member feedback via online questionnaires. The society has not surveyed members in relation to HM Treasury's paper on reforming UK financial regulation due to the extensive number of questions within the paper. As a consequence, the committee's response is brief and addresses only some of the questions posed. However, we make a number of observations that we believe to be important and that we hope will be useful in directing HM Treasury's approach to implementation of the proposals.

Opening remarks

- The aim of the financial system is to ensure that capital is allocated efficiently and that the risk of this capital is priced appropriately
- The events of the last two years have demonstrated that capital was not being allocated efficiently and that the risk of this capital was being mispriced.
- The latest financial crisis should not be surprising as it is the latest in a long series of financial crises; all of these crises share the following three features –
    - Market failure
    - Governance failure
    - Regulatory failure[1]

[1] "Manias, Panics and Crashes" Charles Kindleberger; "A Short History of Financial Euphoria", J.K Galbraith.

CFA UK welcomes and appreciates the open and honest way in which the Treasury has highlighted the weaknesses of the tripartite system. It is imperative that the new framework can learn from history and deliver a more effective regulatory environment which contributes to the efficient allocation of capital and the appropriate pricing of risk.

The new model will need to show that it minimises the financial amnesia of the past[2]. Specifically, the new framework needs to show that the various constituents will communicate effectively; identify problems in the financial system and have the will to respond decisively and quickly to address them; and that its supervision and enforcement brings individuals and firms to account in a way that is a credible deterrent. The new framework does provide some hope in these areas although its structure indicates that it is a response to the causes of the latest crisis instead of addressing the systemic issues that resulted in the crisis.

Research highlights that relying on the tenets of good corporate governance within financial firms will not be sufficient (see Erkens et al[3]) and so an effective regulatory environment is necessary. An effective regulatory environment can contribute to the appropriate pricing of capital and resource allocation.

La Porta et al suggest[4] "these laws and the quality of their enforcement by regulators and courts, are essential elements of corporate governance and finance… in contrast, when the legal system does not protect outside investors, corporate governance and external finance do not work well." On occasion, it may be more beneficial to enforce existing laws and regulations than devise new policies or as La Porta et al state "the strategy for reform is not to create an ideal set of rules and then see how well they can be enforced, but rather to enact the rules that can be enforced within the existing structure."

The interaction of frameworks and regulatory requirements can also help reduce the cost of equity capital. Hail & Leuz (2005) and Leuz (2006) attempt to understand and analyse the complexity of the influences of legal institutions, securities regulation and the level of integration of a nation's capital markets. Emphasising the inherent caveats, they find some empirical support for the claim that firms from countries with more extensive disclosure requirements, stronger securities regulation and stricter enforcement mechanisms (as enabled by a high quality legal infrastructure) have significantly lower cost of equity capital than those that do not rate as highly on these parameters[5]. The table below lists the ten nations with the lowest cost of equity capital derived from the sample cited by Hail & Leuz and how they score with respect to the quality of legal infrastructure (LAW), disclosure (DISREQ) and securities regulation (SECREG).

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[2] Of Laws, Lending, and Limbic Systems William J. Bernstein Financial Analysts Journal, January/February 2010, Vol. 66, No. 1:17-22.
[3] Schumpter: Corporate constitutions; The Economist, October 30th 2010
[4] La Porta, Rafael, Lopez de Silanes, Florencio, Shleifer, Andrei and Vishny, Robert W., "Investor Protection and Corporate Governance" (June 1999). Available at SSRN: http://ssrn.com/abstract=183908 or DOI: 10.2139/ssrn.183908
[5] Department for Business, Innovation and Skills (BIS) Economics Paper No1- BERR's (BIS) role in raising productivity: new evidence ch. 2 http://www.bis.gov.uk/files/file44504.pdf

Country*	Average cost of equity capital (1992 – 2004)	DISREQ**	SECREG**	LAW**
Japan	6.16%	0.75	0.47	0.9
Taiwan	9.87%	0.75	0.64	0.85
Singapore	10.01%	1	0.84	0.86
Germany	10.05%	0.42	0.21	0.92
United States	10.24%	1	0.97	1
France	10.37%	0.75	0.58	0.9
Canada	10.53%	0.92	0.91	1
Italy	10.61%	0.67	0.46	0.83
United Kingdom	10.64%	0.83	0.73	0.86
Malaysia	10.65%	0.92	0.78	0.68

(Source: Hail & Leuz (2005); Note*: sample size differs with country; **based on indices)

General comments

HM Treasury's paper proposes various measures intended to improve the regulatory framework for the UK financial sector. The paper criticises the previous structure and notes that none of the three parties that shared regulatory responsibility had ultimate responsibility for financial stability. The society supports HM Treasury's intention to reduce systemic risk through the introduction of a Financial Policy Committee at the Bank of England to improve macro-prudential regulation of the financial system. The society also supports the establishment of the Prudential Regulation Authority (PRA) as a subsidiary of the Bank of England. It is important to coordinate macro- and micro-prudential regulation and it will be most effective to do so within a single institution.

CFA UK also supports the proposal to separate prudential and conduct of business regulation. These two activities have a different purpose, require different disciplines and may, at times, conflict. The co-location of prudential and conduct of business regulation at the FSA clearly failed. A new approach is warranted.

The society agrees with HM Treasury's proposed approach to locate the regulation of investment management firms at the Consumer Protection and Markets Authority (CPMA), the conduct of business regulator. There is limited systemic risk associated with investment management, which is an agency business rather than an activity where there is significant balance sheet risk. We also support the proposal for the CPMA to have oversight over conduct of business regulation for both the wholesale and retail markets. The PRA should focus exclusively on monitoring and enforcing prudential requirements. Additionally, placing retail conduct regulation in one location should enable the consistent application of regulation across different product types.

Observations

HM Treasury's paper believes the two key failings of the UK's regulatory system at the time of the financial crisis to be regulatory 'underlap' (the failure of responsibility to be clearly identified) and the reliance within financial supervision on 'tick box' compliance.

Communication and Cooperation

CFA UK welcomes the much clearer delineation of responsibilities across the FPC, PRA and CPMA as set out in the consultation paper. As stated previously, we believe it is appropriate for there to be separation between prudential and conduct of business regulation. However, separating these responsibilities across different entities presents a new opportunity for structural failure through absent or ineffective communication and cooperation. The consultation paper states that information gateways will be established between the parties to allow the flow of supervisory information, but there is little additional description of how cooperation and communication may be achieved. Where the process is described, too much faith is put in it. For instance, the final two bullet points in Box 3 B state:

- The PRA and CPMA will, as a matter of course, consult each other on rules which they think may be relevant to the activities of the other; and
- Similarly, the CPMA will be required to consult the PRA in advance of taking any decision that could cause a firm-specific financial stability risk...

The difficulty here is the assumption that each party will understand the other so perfectly that they will correctly identify issues of relevance to each other. We suspect that they will not. Not only will simple human error get in the way, but there may be natural incentives to fail to identify these issues. Consultation and cooperation take time and tends to lead to compromise. Agencies with a clear focus and a determination to meet their goals may be disinclined to compromise.

Strong processes must be put in place to support cooperation and communication. These processes should ensure that all PRA and CPMA activity be reported to the other party so that each side can interpret for itself the potential impact on its area of activity. A common data system should be used across both the PRA and CPMA so that information can be shared at relatively low cost. Communication between and cooperation across the agencies should be a specific area of accountability for both the PRA and CPMA.

Tick box compliance

The society notes that the consultation paper is surprisingly light on the measures that will be taken to address the over-reliance on 'tick box' compliance.

There are several reasons why a culture of 'tick box' compliance might arise. First, the perception or reality of under-staffing might have left FSA representatives with too little time for any other approach. Secondly, the belief that the system was working well may have created a false sense of security that allowed such an approach. Last, poor management (lacking the direct experience of bank failure) may not have seen the need for persistent application of a more rigorous approach.

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

To limit the danger of a return to 'tick box' compliance, HM Treasury should review supervisory best practice internationally and set in place processes to be followed by supervisors within both the PRA and CPMA. Judgment will always be required, but it must be applied within a strong process so that the correct levels of supervisory investigation are taken across market cycles. Colleges of supervisors (as described by CEBS and the IWFC) will likely be a useful source of information on supervisory best practice. Supervisors at both the PRA and the CPMA should be required to report regularly on their adherence to supervisory best practice.

Accountability

HM Treasury's paper was borne from an understanding that the existing, tripartite system had failed and that a new structure should be put in place that would address the failings of the current approach. CFA UK notes, though, that the accountability processes that the consultation paper proposes for the new entities is essentially the same as the one currently used. It is clear that accountability has been insufficient in recent times and this area of the paper should be strengthened.

In CFA UK's opinion, the accountability mechanisms set out in 4.36 are good, but insufficient. Annual reports and annual meetings rarely provide an opportunity for meaningful review of performance. Consultative panels are – as their name suggests – consultative. They can be ignored. While the NAO and PAC will no doubt scrutinise the CPMA's accounts, neither body is well-placed to assess its performance.

CFA UK believes that the responsibilities and powers of the non-executive directors at the CPMA should be described in more detail so as to include the right for those directors to demand an external audit of the authority's performance and/or the performance of the CPMA's management. The non-executive directors should be required to meet regularly with senior representatives of firms that are regulated by the CPMA, with representatives of consumer groups and with senior executives at firms that rely on the efficient operation of the markets governed by the CPMA. This feedback ought to be recorded and reported annually and should be taken into account in determining the effectiveness of the CPMA in meeting its goals.

CFA UK believes that it is important that targets for the CPMA relating to the primary and secondary objectives should be published. The primary and secondary objectives for the CPMA are set at an appropriately high level. The CPMA's executive team should be required by CPMA's Board to set specific sub-targets relating to each of these objectives and the authority's performance relative to these targets ought to be reported by the Board.

A consumer champion

CFA UK is concerned about the focus within HM Treasury's paper on the CPMA's proposed role as a consumer champion. Clearly, protection of the consumer is of paramount importance and the conduct of business regulator should have consumer protection as one of its key objectives. CFA UK believes that consumer protection requires that market integrity be assured through consistent rule-making, supervision and enforcement. HM Treasury's paper acknowledges the importance of market integrity by proposing the establishment of an autonomous markets division within the CPMA. CFA UK believes that this arrangement should be reversed, so that the bulk of the CPMA's activities are related to the protection of market integrity (a necessary condition for consumer protection) with the subsequent establishment of a specialist consumer protection division within the authority. CFA UK believes that the provisionally named CPMA ought to be named the Markets and Consumer Protection Authority.

Nevertheless, we respect the paper's intention to establish a regulatory framework that assures strong protection for consumers. There is sufficient recent history – for instance, endowment mortgages, split capital investment trusts – to demonstrate that close regulation is required for consumers to be treated fairly. Establishment of a specialist consumer protection group within the new body would certainly be justified.

However, organisations require focus. CFA UK believes that the CPMA's primary objective (as set out in 4.6) should be rewritten as: 'The government will legislate to provide the CPMA with a primary objective of ensuring confidence in financial services and markets, *with particular focus on ensuring market integrity and, thereby, protecting consumers*. In a similar vein, we would discourage HM Treasury from introducing a third set of objectives for which the CPMA should have regard. Ensuring market integrity is a steep ambition. The CPMA should not be diverted from that objective by the dilutive influence of a series of other intended outcomes.

<u>Europe</u>

As has been noted by other respondents, the proposed structure for UK financial regulation (FPC, PRA and CPMA) does not mesh well with arrangements at a pan-European level. Only one UK representative agency can participate in the new European Securities Markets Authority. The CPMA should be that agency, but if it is to take on that role, it should not lose responsibility for the UKLA to the FRC. The CPMA will need to cooperate and communicate closely with the FRC and PRA in order to represent UK interests successfully in Europe. The proposal to move the UKLA to the FRC appears unjustified irrespective of the need for effective representation in Europe. The need to support the CPMA's representative role in Europe tips the argument firmly in favour of the UKLA remaining within the CPMA.

<u>Concluding remarks</u>

Changing the regulatory framework is not a guarantee of an improved outcome. HM Treasury's paper suggests that the proposed changes will have certain results. For instance, 2.41 reads: '*The chief executive of the CPMA will sit on the FPC. This will ensure that any systemic risks arising from the activities regulated by the CPMA are correctly captured and identified and that any impact of the FPC's decisions on those activities is adequately taken into account*.' There is too much confidence within this statement. First, there is no guarantee that the systemic risks arising from activities regulated by the CPMA will be correctly captured and identified. That is an appropriate intention, but it is unlikely that it will be perfectly met. Similarly, the presence of an individual on a Board should allow appropriate information to be shared within that group, but it does not guarantee that will happen or that information that is shared will be taken adequately into account. That will be a matter of opinion, which may differ among Board representatives.

The tone of the document suggests that HM Treasury believes that restructuring the regulatory framework will eliminate regulatory failure. It will not. While we support most of the proposals within the report, we believe that the paper contains too little detail on how the new regulatory framework will lead to operational excellence. More emphasis should be put on accountability, best practice in supervision and measures to promote communication and cooperation between the PRA and the CPMA. Further, the CPMA should be allowed to focus primarily on ensuring market integrity while making sufficient provision to ensure the proper protection of consumers.

About CFA UK and CFA Institute

The CFA Society of the UK (CFA UK) represents the interests of more than 9,000 leading members of the UK investment profession. The society, which was founded in 1955, is one of the largest member societies of CFA Institute and is committed to leading the development of the investment profession through the promotion of the highest ethical standards and through the provision of continuing education, advocacy, information and career support on behalf of its members. Most CFA UK members have earned the chartered financial analyst (CFA) designation, or are candidates registered in CFA Institute's CFA Program. Both members and candidates attest to adhere to CFA Institute's Code of Ethics and Standards of Professional Conduct.

CFA Institute is the global association for investment professionals. It administers the CFA and CIPM curriculum and exam programs worldwide; publishes research; conducts professional development programs; and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry. CFA Institute has more than 99,000 members in 139 countries, of whom more than 88,000 hold the Chartered Financial Analyst® (CFA®) designation.

Yours,

N. Winterfrost

Natalie WinterFrost CFA FIA
Chair
Professional Standards & Market Practices Committee

Will Goodhart
Chief Executive

Dear Sirs,

Having looked at an email forewarded by the FSA at your request I have looked at the section relevent to my sector i.e. financial advice and see that there appears to be little difference from the old regime. For example Hector Sants is heading this up and as he is responsible for many of the past problems in all sections of the financial community and had in fact offered his resignation prior to the election there are no discernable changes. The provision of advice and the regulations thereon have gradually worsened in the 35 years I have been practicing and certainly in teh past 13 years since the Financial Services Act was introduced by the previous administartion has become a minefield of largely useless rules and regulations that seem to serve only the employees at the FSA. Clients certainly are not better served as the amount of literature they are expecetd to read for the adviser to keep within the regulations are both confusing and excessive. Furthermore, to keep the rgulator happy I am expecetd to treat each client as an idiot whereby I am expecetd to inform him of the risk taht if he crosses the road he might get run over! I attended a meeting some years ago where John Redwood MP spoke on the subject of Financial regulation as it affected my sector and was infomed that the next Tory administration was fully aware of the nonsense going on at the FSA and would be dealt with - no such luck it seems judging by your 'New Approach'.

I fully expect that this email will be ignored as it dosnt fit in with 'the new approach' and it will be business as usual with Mr Sants introducing his latest set of new rules in 2012 as recently confirmed to us all by him with glee. The direct result will be only the very rich being able to afford proper financial advice. The savings rate will inevitably fall as most investors will remain in low interest baring accounts that hardly make saving worthwhile in the longer term.

If this new regime had any sense at all (which it dosnt in my view) it would concentrate of investment products and collective investment schemes making sure that they all conform to known measurement of cost, universal risk assesment of funds reviewed quarterly, and ensure that each is financially sound before being authorised and not hide behind others when it goes wrong as is the case now. Not our fault is what the FSA usually say - sue the IFA. The adviser and investors should be able to select from funds & schemes that, if regulated, can be trusted to adhere to there stated objectives.

If you do read this I hope that you are at least able to acknowldege my comments albeit I suspect nothing will be taken on board.

Yours faithfully

Stephen Charles
Director

AC Financial Ltd.
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499 Silbury Boulevard
Central Milton Keynes
MK9 2AH

AC Financial Ltd is 'Whole of Market' Financial Adviser and is authorised and regulated by the Financial Services Authority.

Simon Culhane, Chartered FCSI
Chief Executive

CHARTERED INSTITUTE FOR SECURITIES & INVESTMENT

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

8 October 2010

Dear Sir / Madam

Response to HM Treasury: "A New Approach to Financial Regulation" Cm.7874

Please find enclosed the response from the Chartered Institute for Securities & Investment, to the above paper.

Yours sincerely

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Chief Executive

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Response to HM Treasury
"A New Approach to Financial Regulation" Cm.7874

General Comments

This is the formal Response of the Chartered Institute for Securities & Investment (CISI) to this consultation issued by HM Treasury in July 2010. It is divided into two parts; our general comments below and the Appendix with answers to the specific questions.

The CISI is an established Awarding Body for qualifications in financial services and a Professional Body for practitioners. It has around 40,000 individual members in the wholesale and retail securities and investment sector (including students) worldwide. More than 35,000 examinations are taken globally each year across its full portfolio of more than 40 examinations. It also has some 60 corporate members.

The Institute is committed to and practises a holistic, broad concept of competence embracing the acquisition of relevant qualifications by individuals to demonstrate attainment of competence; maintaining and enhancing this through Continuing Professional Development (CPD) and the promotion of trust to investors through the provision of a Code of Conduct and tools to promote and measure ethical standards. It is a Registered Charity and a Chartered Body.

The CISI played a significant role in developing the new professional standards under the FSA's Retail Distribution Review (RDR) through membership of the FSA-led Professional Services Advisory Group, and plans to become a regulator-accredited body for delivering these standards for practitioners. It has also actively publicised the changes to this sector, holding two series' of roadshows throughout the UK for its members.

The Institute understands the background to the Treasury's proposals for a new regulatory structure. In answering the questions in the consultation, the Institute will limit itself only to those which relate to training, competence and ethics, i.e. those which are appropriate to an Awarding Body and Professional Body, rather than a Trade Body.

Our primary concern is that we believe there should be a single regulator for all firms for training and competence. We think that splitting responsibility for this important function between two regulators is a recipe for dilution and confusion. Even if the training and competence rulebooks of the two regulators (PRA and CPMA) were identical, supervision policies would inevitably vary, given the different responsibilities of each of them.

Appendix

The CISI's answers to relevant questions

Consumer Protection and Markets Authority (CPMA)

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

We feel strongly that the public interest requires that the high financial skills for firms' employees should be a key factor for the CPMA or the PRA (if that has any responsibility for training and competence – see answer to next question).

Presently the 11 Principles do not include this – yet this became a key part of 'intrusive supervision' as part of the RDR initiative (and was approved in paragraph 2.24 of the consultation).

Specifically, we would suggest that this commitment should appear in two places in the rules. First as a secondary factor in the new law for the CPMA and, if appropriate, the PRA to have regard to this; and secondly that it should be included as a new Principle for firms. Both should be along the lines of "high standards of financial skills of practitioners". An alternative could be to put this obligation as a new specific element of the "Protection of Consumers" requirement as in FSMA.

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

We limit our comments to training and competence.

We favour the training and competence of all regulated firms and employees – including PRA ones – being the responsibility of a single regulator. Given the proposed structure, this should be the CPMA for the reasons given below:

- The PRA and the CPMA will both have retail firms to supervise so there could be two training and competence rulebooks. Even if they were identical, the objectives of both regulators are quite different, giving rise to different supervisory priorities. This would be emphasised in groups with separate PRA and CPMA regulated firms.
- Splitting the supervision of T&C between two regulatory powers over time could lead to a detrimental divergence in standards and implementation. A second factor is that much of the standard-setting and implementation will be duplicated, resulting in process inefficiencies, greater compliance and cost overheads for firms.
- The separation of training and competence (in the FSA's TC Sourcebook), and competence (from MIFID in the SYSC Sourcebook) is confusing. The new structure gives the opportunity for them to be brought together in a single set of TC Rules which would apply to both retail and wholesale (where relevant).

- The consultation (in paragraph 4.24) helpfully says that the RDR will be taken over by the CPMA. Professionalism is a key part of the RDR proposals, applies to some PRA firms (e.g. private banking) and forms a significant part of the proposed FSA TC Sourcebook.
- The Treasury has decided that the CPMA will supervise all elements of CPMA regulated firms: the PRA will not supervise any elements of CPMA regulated firms. So logically it would be the CPMA, and not the PRA, which would take responsibility for training and competence for all firms.
- The professional standards of the RDR will be delivered by accredited bodies (of which the CISI plans to be one). If training and competence was a dual responsibility, both regulators would need to accredit these for the same functions with considerable duplication of oversight and extra costs for them and indirectly consumers.

In addition, we suggest that advantage should be taken of the opportunity of a new financial services bill to add an exemption under section 349 of FSMA, enabling the regulators to disclose confidential information about individuals or firms to Accredited Bodies under the RDR. Presently, the FSA has explained to us that it has no authority to do this.

Currently, there is a problem that the proposed threshold conditions for approval as an accredited body require it to share information concerning matters relating to the APER Principles for Approved Persons with the FSA "subject to legal restraints". These, and the regulator's inability to share any information with the accredited body, result in the likelihood of parallel disciplinary proceedings against the individual simultaneously. The new law provides an opportunity to resolve this. A number of other bodies have been exempted.

Prudential Regulation Authority (PRA)

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

We refer to our answer to the first question on the CPMA above.

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

We refer to our answer to the second question on the CPMA above.

The Chartered Institute of Loss Adjusters

A new approach to financial regulation

Judgement, focus, stability

Introduction

The Chartered Institute of Loss Adjusters (CILA) represents the interests of its individual members whose predominant activity is the investigation, management, quantification, validation and resolution of Property, Casualty or any other losses (whether insured or not) arising from any contingency and the reporting thereof. Some of the work undertaken by members of the CILA is regulated whilst a considerable proportion of the work undertaken by our members is currently "indirectly" regulated as it is performed for and on behalf of firms that are directly regulated by the Financial Services Authority.

The Consultation paper issued by the Treasury is of interest to our members and, having sought opinion from our members, we submit this comment to the Treasury for inclusion within the consultation process.

Whilst CILA members have an overall general interest in these proposals, our comments have been restricted to areas where CILA members have a specific interest.

The CILA has restricted its responses to areas of interest and to avoid repetition it can be taken that questions unanswered were considered not to be relevant to our members, additionally again for the sake of avoiding repetition the comments can be read as emanating from the CILA following our internal consultation process.

The CILA would like it to be noted that a clear distinction should be made between Insurance and Banking. The impetus behind these proposals is the banking crisis that was attributed to the following:

- global economic imbalances;
- mispriced and misunderstood risk;
- unsustainable funding and business models for banks;
- excessive build up of debt across the financial system; and
- the growth of an unregulated 'shadow banking' system

Whilst questions are not raised on this particular point, the CILA should like to draw attention to the fact that the proposals state that the majority of the Financial Policy Committee (FPC) will be Bank Executives, "to bring the expertise and understanding of the financial system that only a central bank can provide".

Insurance is part of the financial market but is wholly different from banking; the handling of Insurance Claims is arguably another further step away from banking. It is, therefore, of concern that it is proposed that banking executives would or could be dominant decision makers in the regulation of insurance.

The Financial Ombudsman Service is referred to in this document only in relation to funding. The loss of the Insurance Ombudsman Service facilitated non-insurance claims experts mediating on key insurance claims decisions with the result of spurious decisions being made. The proposed changes provide an ideal opportunity to capitalise on the strengths, benefits and success of the UK Insurance market.

Responses to questions relevant to the CILA membership

Question Number	Response
4	The CILA recognises the advantages of one body only and that this body should be independent. The PRA should have regard to the primary objectives of the CPMA and the FPC. The proposal document states that there is a "requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained." Whilst the PRA should regulate standards, it should not restrict the method of delivery that may well enhance standards through competition. This corresponds with one of the objectives set out in (4.10) - the desirability of facilitating innovation in connection with regulated activities and the desirability of maintaining the competitive position of the UK.
5	The members of the CILA see no difficulty with the proposal outlined in 3.16, i.e. The PRA and CPMA each are responsible for granting or amending permissions to undertake the regulated activities. Our members will have a considerable interest in not only who is regulated but also what activities are regulated.
6	Our members, as detailed in response to question 5 above, will have considerable interest in the activities and roles that are to be regulated. It is noted under paragraph 3.17 that the Government will seek the views of respondents when decisions are being made in this respect. Our members would very much welcome inclusion in this consultative process. Our members would recommend the proposal of cost benefit analysis prior to the introduction of new rules.
10	The Government welcomes respondents' views on: *Whether the CPMA should have regard to the stability of firms and the financial system as a whole, by reference to the primary objectives of the PRA and FPC;* Yes. The primary concern is to promote consumer confidence in regulated activities and businesses. *Whether some or all of the principles for good regulation currently set out in section 2 of FSMA should be retained for the CPMA, and if so, which;* Yes. The fundamental regulatory objectives are: market confidence; public awareness;

	the protection of consumers; the reduction of financial crime. The principles to which the FSA must have regard, and which affect the deliberations of CILA, are: any burden or restriction imposed by regulation should be proportionate to the benefits expected to result; the facilitation of innovation; the ability to undertake international business competitively; ensure that regulation does not generally have adverse effects on competition; the need for competition between regulated businesses. There are other provisions that have no impact on our work, mainly concerned with the workings of the FSA internally. Amongst the duties of the FSA are those of: making rules; preparing and issuing codes; giving general guidance (considered as a whole); determining general policy and principles. The first two of these seem to have particular reference to our work within what will be the CPMA. This is all pretty general and to a large degree the FSA – in our sector, at least – has already done this. It should be understood that members of The Chartered Institute of Loss Adjusters represent both insurers and/or policyholders in the submission of their claims. Those that represent policyholders have expressed a view that moving from rules-based ICOB to principles-based ICOBS is regretted. However, this is not a view of all members as those who work on behalf of insurers thought that moving to a principles-based ICOB would promote correct behaviour. *Whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained; and* As PRA - As is often the case the UK proposes a gold plated response. The effect of this is potentially to make UK firms less competitive in an EU market. *Whether there are any additional broader public interest considerations to which the CPMA should have regard.* As PRA - No
11	With reference to point 4.33 we believe that the non-executive board

	should include both consumer representatives along with the representatives of some of the SME practitioners in the various activities that fall within its remit. In the insurance claim scenario these SME practitioners should include Chartered Loss Adjusters negotiating claims for policyholders. We feel that it is important to ensure the voice of SME practitioners is heard. With reference to point 4.38 as both practitioners and consumers we have seen little evidence of these panels and we would welcome their higher profile. We would propose easier access to them and promotion of their existence. We consider that the panels should provide a single complaints mechanism to report issues and for the investigation thereof. Where malpractice is reported the action taken by the regulatory body should as far as possible be transparent and demonstrative in terms of the action taken.
14	We consider that the FSCS should be better segmented. For example our members should not pay for the failure of Northern Rock, in this scenario our members are no different to any other consumer.

Other comment

The Chartered Institute of Loss Adjusters Claims Consultancy Specialist Interest Group is particularly concerned about the way in which complaints concerning the acceptance of claims and the amount paid out, are handled.

Two types of complaints should be considered, redress for incorrect claims handling by insurers and complaints concerning conduct.

<u>Redress for incorrect claims handling</u>

The FOS can currently make an award of up to £100,000. We propose that this should be reviewed in the light of the typical extent of cover provided to individuals and others who are able to refer such issues to the FOS. This review should take account of the purpose of the FOS and the resources of the FOS.

The rules concerning disputes which can be referred to the FOS are confusing. The current rules for eligibility are as follows:

Any individual
A business with turnover of less than £2,000,000 employing less than 11 staff
A trust with assets of less than £1,000,000
A charity with turnover of less than £1,000,000

The eligibility rules need consistency and clarity and all of the limits should be reviewed.

We consider that there should be a fast track facility to handle urgent disputes where delay in resolving the issue increases the financial hardship of the claimant.

Conduct

We believe that there should be a mechanism to require insurers to deal with claims promptly and fairly and to ensure that only those firms which are properly authorised and regulated can represent policy holders.

Under the FSA regime while these rules exist the complaints procedure is ineffective and, in our experience, the FSA has made no attempt to properly enforce its rules. For example when duty bound to report an unauthorised firm to the FSA for carrying out regulated activities the FSA shows little interest and has been happy to allow such situations to continue and a practice as detailed under point 11 should be adopted.

Summary

The Chartered Institute of Loss Adjusters is keen to ensure that matters within the proposal document that affect its members are understood and the Institute would welcome further input into the consultation process.

This review has also caused us to consider another point. The Insurance Mediation Directive does not require those who offer a claims preparation service as an incidental service to be registered. As a result such activities are not regulated. This creates an apparent anomaly. It suggests that experts handling such work all the time have to be regulated, but those who might only occasionally provide these services are not regulated. Surely to protect the consumer, all who offer such services ought to be regulated. Particularly those who do not specialise in claims handling. This situation exists where the service is delivered by a member of a designated professional body.

The Institute can be contacted as follows:

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

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

Copy: Stephen Haddrill, Financial Reporting Council

18 October 2010

Dear Sir,

A new approach to financial regulation

The Chartered Institute of Management Accountants (CIMA) is pleased to have the opportunity to comment on this consultation. CIMA, founded in 1919, is the world's leading and largest professional body of Management Accountants, with 172,000 members and students operating at the heart of business in 168 countries. There is a demonstrable need to rebuild public confidence in the financial sector and we have a shared interest in assisting with this process and to enhance consumer protection.

Our response refers to question 17 of the consultation document relating to the proposed transfer of the UK Listing Authority (UKLA) to the Financial Reporting Council (FRC)

The FRC already controls most aspects of corporate reporting in the UK through a series of subsidiary boards and units and it is the FRC that write and reviews the Corporate Governance code and Stewardship Code for Investors. Bringing together oversight of entrants to the market with on-going oversight of governance, accounting and reporting seems logical. We recognise that there are some legitimate concerns about the proposed transfer but on balance we support the move as a step towards creating an overarching regulator for company activity.

Early contact between the FRC and new market participants should help those participants to comply with ongoing FRC requirements as well as provide the FRC with an opportunity to engage more directly with investors through the process of setting the 'Initial Public Offering' requirements. However, we do have a concern that the pace of activity within the FRC in dealing with changes to company regulation is insufficient to cope with that required by the work of the Listing Authority. The FRC would need to recognise these different requirements and structure its new listing authority section in such a way as to allow it to act quickly in response to market demands.

Concerns have also been raised about the reduction in the UK voice at key European forums that could result from the Listing Authority moving to the FRC. Such a reduction in influence would be very detrimental to the UK and the FRC should take steps to ensure that the full weight of UK interests continues to be felt in Europe.

The FRC will incur additional costs as a result of taking on the proposed additional workload. These costs should be borne by the market participants that raise capital through the exchange and the auditors and other advisors that earn fee income from the IPO process rather than by a general increase in the FRC levy which would increase costs on those not directly involved.

Likewise cost increases that would result from any change to the remit of the Accountancy and Actuarial Discipline Board, for instance to cover cases previously dealt with by the Financial Services Authority (FSA), should be recovered in a targeted manner from the classes of market participant directly involved.

The proposal to transfer the powers of the UKLA to the FRC is part of a wider proposal mainly involving a transfer of powers from the FSA to the Bank of England with the aim to ensure ongoing financial stability for the UK. The majority of the additional costs that result from this proposal would be incurred by the Bank of England. However, to the extent that additional costs for financial stability purposes are incurred by the FRC it does not appear equitable to us that these costs should be levied on the normal contributors to the FRC as financial stability is of interest to the economy as a whole.

We would be pleased to discuss with you any aspect of this letter that you may wish to raise with us.

Yours faithfully

CHARLES TILLEY
Chief Executive

Consultation Response

HM Treasury: A New Approach to Financial Regulation

Submission from the Chartered Insurance Institute

October 2010

SUMMARY

- While there is strong political will for changing the UK regulatory system, we have some concerns about the proposals for reform, and how the new system might operate, particularly as it impacts the general insurance sector.

- The timeframe for transition to the new framework is challenging making it harder for the regulator to continue to pursue important projects like the RDR and Solvency II. These reforms must not detract from developments at the European and indeed global level.

- Creating two regulators rather than one may swap a supervisory underlap for an overlap. The new structures risk becoming bureaucratic and unclear as to which body does what.

- The consultation does little to reassure that the insurance market will be treated differently. Instead, the proposed "one size fits all" approach to regulation appears to punish the insurance industry for the banking sector's failures. More importantly it fails to recognise and regulate the different nature of insurance appropriately.

A regulatory dividend for professional standards. We propose that firms that are proven to adopt enhanced professionalism and ethics in their corporate culture and day-to-day activities should be afforded some sort of concessionary treatment by supervisors.

We believe that embedding such a regulatory dividend can form part of the FSA's (and successor bodies) new recognition of the importance of culture and behaviour of individuals and firms. We also think this step is consistent with the Coalition's pledge to *"end the culture of tick-box regulation and instead target inspections on high-risk organisations through co-regulation and improving professional standards*". This, we argue, will tackle some of the faults of the past system and incentivise appropriate behaviour and culture and, ultimately, improve public trust and confidence.

CII

Our Overall Views: An Opportunity to Raise Public Trust and Confidence

Our consultation response outlines four main themes:

1. **There is a major opportunity to create a „*regulatory dividend'* for firms who adopt and champion professional standards beyond minimum compliance. The CII's General Insurance Initiative – the Aldermanbury Declaration – is a case in point.**
2. **We believe this fits well with a culture of targeted and proportional regulation.**
3. **Further to this „hardwiring of professional standards' there should be greater recognition of the support and encouragement offered by professional bodies in developing individual behaviour and supporting better firm culture through a framework of adherence of professional standards e.g. the CII's chartered firms initiative or aspects of the Retail Distribution Review.**
4. **Insurance is different to banking and therefore reform to regulatory structures needs to reflect this.**

There is little in this consultation to reassure the insurance industry that it will be treated differently

Overall, while there is clearly a strong political impetus for these changes we are concerned that the consultation document does little to dispel many of the fears expressed by the insurance industry and elsewhere in response to the Chancellor's Mansion House speech on how these changes will be implemented, particularly as they impact insurance.

For example, one major concern is the possible regulatory cost for firms from transition costs, especially small businesses, as a result of splitting the financial regulator into two bodies (PRA and CPMA), and whether the new system would be designed in a way that takes into account the different systemic risks posed by insurance to banking.

We think that the consultation paper does little to ease these concerns, providing little peace of mind to the owners of small insurance firms. Other than a brief statement to Parliament by Mark Hoban, the Government has yet to demonstrate any clear detail to back the intention to treat insurance and banking separately under the new system. We believe that the response from the Government must set out substantive proposals to allay the market's concerns in these areas.

We agree with the tenor of the CBI's response that:

"Major financial reform is both necessary and underway at international, European and UK level in the wake of the financial crisis. The status quo is not an option. But we need a clear focus on what the reforms are designed to achieve, what mix of proposals will best deliver this objective, and what approaches we favour."

The changes in the UK should not be delivered in isolation from EU and global developments and should not lead to UK authorities taking their collective „eye off the ball' in these arenas. As the CBI goes on to say:

"The cumulative impacts of regulatory change should not we believe be underestimated. Since the financial crisis significant work has been underway at international level to address the underlying causes. Firms have and will continue to undergo substantial change to be safer and better able to withstand shocks. However not all firms posed the same level of systemic risk and were not directly involved in the principle causes of crisis. In changing the regulatory structure there will be costs and inevitably some management distraction".

We welcome the opportunity to respond to the Retail Distribution Review consultation. Levels of qualifications and behaviour across the market are being raised, and we believe this will bolster the public's trust and confidence in the sector.

Professional Standards – the key to supporting the new regulatory culture

We caution against a reinvention of the regulatory framework which could threaten the continuity of projects like the RDR and Solvency II

In response to the concerns described above, we argue that key to improving the quality of financial services and winning back the public's trust is a renewed drive for professionalism and ethical behaviour across the industry. We argue that this drive should focus on ensuring that the new regulator builds upon the good work already done in this area by the FSA and reflects the new emphasis on ethical behaviour and culture within firms. In this context, we caution against a complete reinvention of the regulatory framework where possible, which we think could threaten the continuity of important projects like the RDR and Solvency II. Although the Government has tried to reassure in speeches that these work strands will continue as planned, we believe that market concerns in this area are still justified.

Embedding professionalism in the regulatory culture would fit the current political mood to the end tick box mentality

This approach is certainly consistent with the current political mood. The Coalition Agreement of the UK Government published in June states:

"The Government believes that business is the driver of economic growth and innovation, and that we need to take urgent action to boost enterprise, support green growth and build a new and more responsible economic model. We want to create a fairer and more balanced economy, where we are not so dependent on a narrow range of economic sectors, and where new businesses and economic opportunities are more evenly shared between regions and industries.

"We will end the culture of „tick-box' regulation, and instead target inspections on high-risk organisations through co-regulation and improving professional standards".

We believe that the idea of embedding professionalism in the regulatory culture of the UK is sympathetic to the political imperative demonstrated above.

On a more general point, a central thrust of the proposals is about embedding a more intrusive approach to regulation but there seems to be little evidence that firms will be rewarded for good behaviour. This is particularly the case for firms that have pursued professionalism and ethics. Given that adopting such principles could be a very powerful incentive for firms to take well judged decisions, we would argue that the Government's proposals should reflect some measure of „regulatory dividend' if they comply and indeed excel in meeting the professionalism and ethics agenda. It would makes sense if the new regulatory is intervening earlier and is intent on making „judgement on judgements' then a clear bias in favour of firms investing in professional standards is hard-wired into the compliance process and „arrow visits'.

We offer two examples of where CII initiatives are leading the way on improving professional standards in financial services

We offer two examples of where this is already happening. First is the Aldermanbury Declaration, and second is our Chartered Firms initiative.

1. The Aldermanbury Declaration initiative

In cooperation with leading figures in the general insurance market, the CII formed a task force in 2009 to raise professional standards in general insurance. This was driven by the desire for the market to lead these reforms on its own initiative rather than as a result of regulatory imposition. The result was the Aldermanbury Declaration published in March 2010 calling on the sector to commit to a common framework of professional standards for its practitioners. The Declaration seeks to deliver the following benefits:

The Aldermanbury declaration calls on the insurance sector to commit to a common framework of professional standards for its practitioners

- 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.

We believe these proposals are ambitious but realistic and have called on all firms signing up to implement the changes by December 2013. Full details of the Aldermanbury declaration and its requirements can be found at: **www.cii.co.uk/aldermanburydeclaration.**

By September 2010, six months from the launch of the Declaration, we have secured over a hundred signatories from leading firms committed to this. A full list can be found at the link indication in the previous paragraph.

At the heart of Chartered status for firms is a desire to help the financial advice and broking disciplines improve standards of knowledge and behaviour and, in turn, levels of professionalism.

2. Chartered Firms

In 2008, the CII has developed and launched the concept of chartered firms to demonstrate and develop professional standards within a firm.

Chartered firms must ensure staff members acquire and retain the knowledge necessary to be competent in their roles. They must follow a code of ethical practice that places client's interests at the heart of the service they provide. As such it is an exclusive and valuable distinction.

In addition chartered status, granted by the Privy Council, gives insurers parity with other professional firms and distinguishes insurers from competitors and peers. It strengthens bonds of confidence and trust with consumers."

At the heart of Chartered status for firms is a desire to help the financial advice and broking disciplines to improve standards of knowledge and behaviour and, in turn, levels of professionalism. This can be achieved by creating a framework that encourages and supports firms as they strive to raise standards of capability and ethical practice. A corporate Chartered title is therefore a commitment to an overall standard of excellence and professionalism.

To support leading firms in the financial advice and insurance sector, and to recognise their adherence to the highest standards of professional practice, the CII has a series of corporate titles: Chartered Financial Planners, Chartered Insurance Brokers, and Chartered Insurers

Currently we have over 300 firms with chartered from status.

Both these initiatives demonstrate that a movement towards stronger professional standards is already under way within the insurance industry, as it is in the financial planning market, and therefore efforts by Government to recognise, acknowledge, support and even promote this work through regulatory means could well result in a quick victory in the regulatory reform agenda.

Driving good behaviour through exemplars

Positive incentives are particularly important given that, as things stand at the moment, the proposed reforms will require a major change for businesses and regulators in the UK. In this regard, it is imperative that care is taken to avoid swapping too little regulation for too much. The current FSA has said that outcomes will be paramount.

We agree but this must be clearly signposted so firms understand what good looks like. This points to the opportunity for promotion of exemplars and good practice. Particularly for the SME sector, one off and ongoing increases in the costs of complying with regulation during challenging economic times could put firms out of business. This does not discriminate between good and bad practice.

Insurance is different from banking

There are clear and undeniable differences between the risk characteristics of the banking and insurance industries. A one size fits all regulator is ill equipped to distinguish between these different risks.

Similarly, with respect to the regulation of banking versus insurance (particularly general insurance), we argue that there are very real practical reasons to treat the two types of financial services differently in the future architecture.

Insurance and banking are fundamentally different, highlighted by the relative success of insurance over the near collapse of banking during the financial crisis as well as the more long term nature of insurance and its different attitude to risk. For example, a report by the OECD published earlier this year highlighted clear and undeniable differences between the risk characteristics of the two industries, and prescribed a unique regulatory approach for insurance with the following measures:[1]

- **Promote strengthened ongoing surveillance:** the OECD insurance statistics framework will be enhanced and its surveillance efforts increased to the extent enabled by OECD resources. The International Association of Insurance Supervisors (IAIS) is also expected to enhance its surveillance activities.
- **Encourage greater consideration of macroeconomic linkages:** greater consideration should be given in policymaking, regulation, and supervision to the inter-linkages between insurance markets and the broader economy, as well as to macro-prudential risks. While important, the risks facing individual insurers should be understood in a broader context, including in relation to other institutions in the financial system (particularly given differences in business models) and to broader macroeconomic conditions.
- **Strengthen insurer corporate governance standards:** the crisis has provided some direction as to how existing OECD guidelines on insurance corporate governance can be improved, for instance in relation to board practices and risk management.
- **Consider "too big to fail" and systemically important insurers:** financial institutions (whether engaged in banking, insurance, and securities markets) that are very large may be considered to be too large to fail, potentially leading to moral hazard and thus increased risk-taking behaviour.

In the light of this, a one size fits all regulator might not be able to appropriately distinguish between the different risks. It may be ill equipped to implement the separate international rules for banking and insurance about to come into force.

Our surveys indicate increasing member support for the RDR professionalism package

CII Member Research

Our perspectives reflected in this consultation response are based on a member survey we undertook in August 2010. Key headlines are shown below (*detailed results can be found in Appendix 1*):

- There are significant numbers who question whether change will lead to an improved system and whether the timetable is realistic. There was greater scepticism from the general insurance side of our membership.
- The majority believe that the FSA's new „intrusive' regulation will continue under the new system.
- Members also believe that the FSA should work closely with professional bodies to promote & police ethical behaviour.

[1] The Impact of The Financial Crisis on the Insurance Sector and Policy Responses, OECD, 30 April 2010. See also for example, Geneva Association, Systemic Risk in Insurance: An Analysis of Insurance and Financial Stability, March 2010

Issues

We argue that the Government should build on the developments already underway on improving professionalism in financial services, and propose a regulatory dividend for „good firms' that comply with the professionalism agenda.

Both ideas fit neatly with Hector Sants' belief that culture can and should be regulated. We also propose changes to the Governance and accountability of the FPC to help ensure that banking and insurance are treated differently.

The CII hopes that the Government seeks to build on the parts of the current regulatory environment where it is already successfully operating rather than reinventing it entirely

1. Professionalism – unlocking better trust

In recent times the FSA has made great strides in promoting and embedding professionalism within the regulatory framework. An example of this is the Retail Distribution Review (RDR), which has the potential to alter the *„perverse incentives' for mis-selling products and services created by the profound „imbalances of knowledge and power between consumers and providers*' (Lord Turner, Mansion House: 2010)

The RDR, taken with the challenge of Solvency 2 represents very substantial projects with the potential to reshape UK financial services. Changing the regulatory architecture at such a moment offers dangers and unintended consequences and threatens successful implementation of these projects if focus is diverted from them. While we agree that changing the architecture may be worthwhile, the CII hopes that the Government seeks to build on the parts of the current regulatory environment where is already successfully operates rather than reinventing it entirely.

We accept that there is strong political will to change the UK regulatory architecture. Indeed, we acknowledge the argument that giving ultimate responsibility to the Bank of England for financial stability may help to prevent the kind of paralysis that gripped our regulatory system before, and in the initial stages of, the financial crisis. This view was echoed in a recent survey of our members with 57% agreeing that a major reorganisation of regulation in the UK was needed.

Recent changes to European supervisory architecture may limit the possibility for significant reform at a national level

Nevertheless the CII takes the view that a complete reinvention of the regulatory environment, i.e. a revision to the Financial Services & Markets Act is also unrealistic and potentially diverts focus from other challenges. For example, the changes to the European supervisory architecture now due to come into force this January will create significant new powers for those institutions. This would in turn limit the possibility for significant and structural reform at the national level, despite the reassurances that national supervisors would still be afforded control over firms within their jurisdiction.

More people are going beyond the proposed new benchmark demonstrating a commitment to professionalism

Incentivising better standards and behaviour through professionalism

The CII accepts that in order to guard against future financial crises, the culture associated with the new regulatory architecture may need to become more intrusive and preventative. In turn, by having two regulatory bodies rather than one, the new system may also result in potential confusion in practice, particularly where the two bodies intersect. The new regulators must understand that such a regulatory environment may act to increase firms' administrative costs. It is worth noting that 51% of our members think that the proposed new system will be just as intrusive as the current one has become.

A regulatory dividend would be particularly powerful for nudging small firms to adopt good practice and develop ethical and professional standards beyond the minimum compliance

The CII feels that, positive discrimination to incentivise „good behaviour', in the form of a regulatory dividend, should be an intrinsic part of the new system and part of the FSA's efforts to instil an ethical culture throughout the sector. This would be particularly powerful in nudging small firms to adopt best practice and develop ethical and professional standards beyond the minimum compliance.

Small firms with fewer resources than larger firms are less able to cope with additional regulatory intrusion and to comply with the whole panoply of compliance required. By „hard-wiring' into their reforms a „regulatory dividend' for firms who can demonstrate professionalism is at the core of their culture, the Government could build in to the regulatory structure an approach which incentivises good behaviour by firms through a regulatory dividend.

How this regulatory dividend would be shaped would need to be properly articulated but could form part of an ARROW regulatory process (e.g. a chartered firm could receive a positive endorsement as part of a regulatory scorecard) or a reduction in compliance fees. This would help differentiate between, for example, the 3,800 professional brokers as opposed to the wider pool of 8,550 firms who have some form of General Insurance regulatory permission. The current regime makes no distinction between the two groups. We believe higher standards can and should form some part of future regulatory indicators.

Those firms that develop better behaviour through professionalism and ethics should be credited as part of a regulatory scorecard. In turn these firms should face less focus for future regulatory action

Associated with the decline in confidence for financial services, has been a growth in demand for professionals who can be trusted to provide sound advice on financial products and services. It follows that individuals and firms that are known to provide good and honest advice are able to generate more business and larger profits. Therefore, by getting firms more engaged in the professionalism and ethics agenda, the new regulator can foster better behaviour whilst also providing tangible benefits to the firm, and more importantly, benefit to the public at large.

Over time, those firms that develop better behaviour through professionalism and ethics should be credited as part of a regulatory scorecard and this should be an indicator to contribute to less focus for future regulatory action. For those firms demonstrating a professional culture – e.g. appropriately qualified staff, appropriate CPD, and commitment to a code of ethics or similar internal company standards, the regulator should be less intrusive leading to some form of a regulatory dividend.

The new regulator should build on the initiatives like the RDR and the Aldemanbury Declaration, working alongside professional bodies to push forward the professionalism agenda

The new regulator should therefore build on initiatives like the Retail Distribution Review and the insurance industry's Aldermanbury Declaration, working alongside professional bodies such as the CII to push this agenda forward. Our members are also of this opinion, with the vast majority (90%) agreeing that the FSA and professional bodies should work together on initiatives to promote ethical behaviour.

These are also the conclusions of the FSA's own research to assess the link between increased professional standards among investment advisers and levels of consumer trust and engagement with the industry.[2] They found that where a strong personal relationship does not exist or where an individual has no previous experience, the drivers of trust can be more symbolic in nature. In the absence of a personal recommendation, consumers will look for signals that demonstrate reputation and trustworthiness. In some markets, brands may act as the chief signal whilst in others, particularly those where advice is given, the badge of professionalism may act as a proxy for trustworthiness.

The FSA's review of existing trust and consumer behavioural research suggests that outside of close personal relationships, consumers look for evidence of ethical behaviour and that competence in an adviser may be measured by their membership of a professional body. Ethical codes and other evidence that the customers' needs take precedence over the needs of the adviser also help generate an image of trustworthiness. Increasingly, the professions have also had to show that they are open and subject to independent scrutiny and have had to demonstrate higher standards of ethics and continuing professional development. There is a strong link between higher qualifications and better outcomes for consumers.

According to the FSA higher qualifications and greater professionalism are correlated with better outcomes for consumers

As part of the review of the new regulatory culture which will inevitably be part of the formation of the new regulatory structure, it might be worth considering some of the suggestions of the Future of Banking Commission which recommended a Professional Standards Board independent of the new regulator. A similar suggestion of an independent professional standards board was, for a while, part of the package of proposals for the Retail Distribution Review, but was dropped, in our view erroneously.

In CP10/14 the FSA give an overview of data gathered on the level of qualifications of financial advisers, and the percentage of adviser deemed to be suitable or unsuitable. The advice of Chartered advisers was deemed suitable in 71% of cases and unclear in 29% of cases, compared to Diploma level advisers deemed suitable in 43% of cases, unclear in 32%, and unsuitable in 25% and Certificate level suitable in 11%, unclear 60% and unsuitable 29%.

The link between professional standards and quality of advice is further confirmed by an internal review carried out by a major banking group which analysed the quality of advice provided by those advisers qualified to level 4 compared to those at level 3. If found that for level 4 advisers the average measure of poor quality was 20% lower than for those

[2] Research report by Jackie Wells and Mary Gostelow, part of FSA CP09/31 Delivering the Retail Distribution Review: Professionalism for Retail Investment Advisers, Dec 2009, http://www.fsa.gov.uk/pubs/other/psct.pdf

qualified to level 3 only. For level 6 qualified advisers, the improvement was a 33% lower fail rate.

Thus, the FSA concludes: "Higher qualifications are correlated with better outcomes for consumers" and, "Overall, we have seen that higher professional standards can lead to better outcomes for consumers."

We believe that embedding the demonstration of professionalism is a positive „nudge' towards better ethical conduct and better outcomes for consumers.

2. Can Culture be Regulated?

The Chief Executive of the Financial Services Authority Hector Sants made a speech on 4 October on the theme of driving better behaviour through regulatory means. He said

Poor cultures often drive poor decision-making and cultural change is essential to minimising the probability and severity of the next crisis.

"I would argue that some of the causes of the crisis were deeply rooted in behavioural or cultural issues that resulted in actions and decisions that, with the benefit of hindsight, were not the „right' ones. Indeed, there are examples of actions and decisions by senior management that can be seen to be at the root cause of their firms' demise…we all know that most major institutions have a „set of values' to which they ascribe – however, in many cases there is a gap between what they claim to do and what they actually do. These values also tend not to be aligned or „lived' by the employees, meaning the firm does not „practice what it preaches'.

"The conclusion I draw from these observations is that poor cultures often drive poor decision-making and that cultural change is essential if the industry is to minimise the probability and severity of the next crisis and regain the trust of society."

He set out the following points:

- No set of economic rules or supervisory architecture can ensure that failures are eradicated – at least none that are affordable and continue to allow innovation and risk.
- Behaviours and judgements must also be addressed and until this happens we will not restore trust in financial services.
- Argues that the word „culture' is better than „ethics' from a regulator's perspective. He defines culture as the „values to which a firm ascribes'
- Asserts that poor cultures in firms were a „key driver of the crisis'
- Maintains that in many instances there has been a gap between what a firm practise and what it preach
- To regulate a firm's culture therefore, regulators must focus on the „actions which a firm takes and whether the board has a compelling story to tell about how it ensures it has the right culture that rings true and is consistent with what the firm does'.

Mr Sants goes on to suggest a rough framework which regulators could use to judge the cultural judgements of firms:

- Do management model good behaviour, i.e. make their values „live'?
- Do management articulate a clearly understandable strategy?
- Do management offer guidance and training to assist in good decision-making – for example, on ensuring the fair treatment of customers and effective risk management?
- Do management incentivise good behaviour and deter poor behaviour and how?
- Do management encourage the required diversity to facilitate challenge to „group-think'?
- Do management articulate their vision of the right culture?

He goes on to say:

"to be completely clear a box-ticking approach to regulating culture will not work".

And that:

"on influencing training, the FSA's regime requires firms to ensure that individuals receive the appropriate training. This can undoubtedly play a significant role in modifying behaviours."

A regulatory regime that encourages professional standards would surely fit comfortably with this approach. We also believe professional bodies can and play a vital role in delivering this is the public interest, and this would be consistent with the "accrediting bodies" approach currently being adopted by the FSA under the Retail Distribution Review.

3. Insurance – Needs Appropriate Treatment

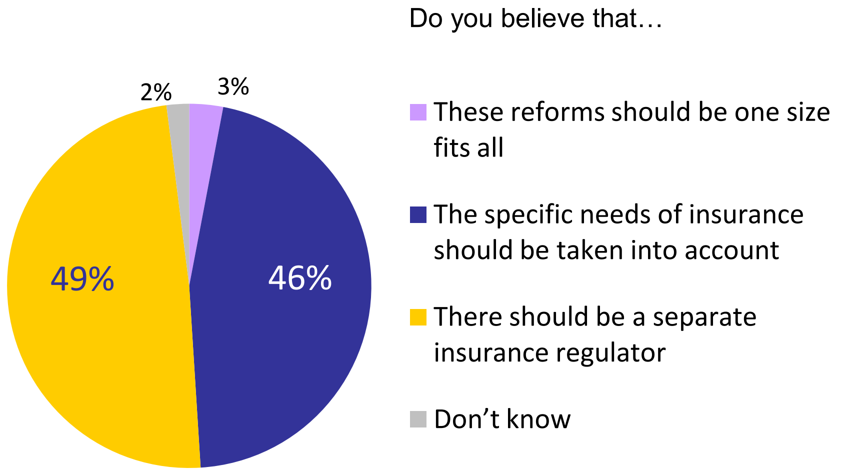
Our members are near unanimously against a one size fits all regulator with only 3% in favour of such an approach

In a statement to the House of Commons, the Financial Secretary to the Treasury has said that regulators must „distinguish between what has happened to the banking sector and the relative success of the insurance sector'. This is encouraging as it suggests that the Government is ready and willing to differentiate between insurance and banking. However, there was nothing in the consultation that did anything to suggest that insurance will be treated any differently once the new regulatory architecture is complete.

Our members are near unanimously against a one size fits all regulator with only 3% in favour of such an approach. The vast majority were either of the opinion that there should be a separate insurance regulator (49% of members), or that the specific needs of insurance should be taken into account (46% of members).

Figure 1: Attitudes towards proposed reforms

Question: There have been comments that the proposed reforms were designed to meet failures in banking supervision and do not take into account separate requirements of insurance.



By and large, with the exception of monoclines and trade credit businesses, insurance firms were generally not exposed to any of the factors that caused the financial crisis

Our view is that while there is a desire for a separate regulator, this is unrealistic and would probably complicate the proposals unnecessarily but does reflect the strong concern that regulations designed to „fix' a banking problem could adversely impact insurance.

It is worth reiterating that banking and insurance have experienced very different fortunes over the last couple of years underlining the different risks related to each type of financial service. In 2008, the banking sector nearly collapsed, primarily as a result of three factors:

- failure to understand the risks associated with securitisation and credit derivatives
- reliance on short term wholesale funding to finance debts
- weak capital adequacy positions.

By and large, with the exception of monolines and some trade credit businesses, insurance firms were generally not exposed to any of these factors, and have noticeably strong capital positions with little reliance on short term wholesale funding. This was also the conclusion of a report by the OECD into the implications of the global financial meltdown on the insurance industry. Its key findings were:

- **Insurers had generally limited exposure to toxic assets:** while the banking sector was heavily exposed to sub-prime mortgages and their associated collateralised debt obligations, this was not a significant exposure in the insurance industry. Some insurers (particularly in the life sector) had made exposures into the sub-prime market, but this was miniscule compared to banks. By January 2010, total write-downs and credit losses reached $1,230 billion for banks and only $261 billion for insurers, of which 37% was down to AIG alone.
- **Insurers' preference of bonds protected them from equity market volatility:** analysis of insurers' investment portfolios suggests a clear preference towards fixed interest securities and bonds as opposed to equities.
- **Despite the optimism, many insurers are experiencing an albeit manageable profitability squeeze:** analysis of insurer profitability using several measures suggest they are undergoing a profit squeeze, however they are likely to manage through as a result of investment earnings.

As we approach a new era in regulation it is vital that regulators understand the very different post crisis starting positions and risks posed by the banking and insurance

As the International Association of Insurance Supervisors stated in its June 2010 position paper[3]:

"*For most classes of insurance...there is little evidence of insurance either generating or amplifying systemic risk within the financial system itself or the real economy.*"

Therefore, as we approach a new era in regulation for financial services, it is vital that regulators understand the very different post crisis starting positions and risks posed by the two sectors. That is not to say there are no systemic risks or that insurance needs a lighter touch.

To lend further weight to the argument against a „one size fits all' regulator, it is worth reflecting on the various strands of multinational regulation currently in the pipeline that will force the UK regulators to treat banking and insurance differently – both in terms of rules and implementation timeframe. With respect to insurance, Solvency II will come into force on the 1 November 2012, replacing the FSA's current risk management and capital requirements. By contrast, for banking, Capital Requirements Directive (CRD) III will come into effect on the 1 January 2011 at the latest. And, building on CRD III, Basel III rules must be fully implemented by 2019. Given the separate timeframes for implementation, and the sector specific nature of the proposed rules, there is a very real practical reason to treat the two types of financial services differently in the future regulatory architecture. Despite efforts to put the market at ease by developing transitional arrangements for advisers currently in the market, there is still uncertainty over transition arrangements for trainee advisers. We are informed that some firms

[3] IAIS Position Paper on key financial stability issues 4 June 2010

have ceased or deferred recruitment programmes until clarity is provided on these issues. This is not helpful for a profession that needs to grow.

The FPC needs to be more accountable via greater public scrutiny, and a requirement for the body to consult with the Chancellor whenever economic threats emerge that require policy measures

Embedding accountability and insurance expertise within the Financial Policy Committee

Giving ultimate responsibility to one body for macro and micro prudential supervision (the FPC) should help to facilitate a more focused approach to crisis prevention. However, there is that the concern that the FPC will have a great deal of power – both in determining what the emerging economic threats are and what we should do about them. This concern was recently echoed by Lord Myners when he asserted that the new system makes the Governor of the Bank of England „too big to fail,' with a considerable amount of expectation placed upon him. In addition, with little insurance related expertise alongside its immense strategic power, there is a substantial risk that the FPC may facilitate the creation of a one size fits all regulatory system.

In response, we suggest that the FPC is made more accountable via greater public scrutiny, and that there should be a requirement for the body to consult the Chancellor whenever developing policy measures to deal with emerging economic threats.

4. Importance of Consumer Protection

As a final point, we wish to highlight the importance of implementing an adequate consumer protection regime within the new regulatory architecture, and a fundamental review of financial services consumer protection is necessary. First, we are concerned that consumer protection in specific parts of the industry could be lacking in areas where regulatory powers are unclear. For example unsecured and secured lending, as well as particular parts of the latter. These faultline areas could be a significant source of confusion and detriment and there now exists the opportunity to correct this through a single financial services consumer protection regime.

Secondly, we have concerns that the new structure makes the mistake of perpetuating the flawed wisdom that conduct of business regulation ostensibly delivers consumer protection, where in fact this is only part of the picture. While specific rules conduct of business combined with higher level principles are important in shaping the day-to-day activities of firms, the extent to which a firm organises its strategic activities and is governed at the highest levels also needs scrutiny for consumer principles. We have seen in the last decade how firms have adopted a "tick-box attitude" complying with FSA rules but still allowing practices and cultures that are detrimental to consumers. Moreover, it must be recalled that Northern Rock performed very well in FSA thematic investigations of its mortgage and equity release conduct of business in 2005-2006, while more serious problems around it prudential activities went unchecked.

We would argue that the Government should take this opportunity to consult the industry on a new more strategic approach to consumer protection. One that examines how firms match commercial objectives with consumer welfare, and one that instils ethical principles at all levels within firm structures, regardless of their type of business structure. Given the planned closure of Consumer Focus in the Spending Review, and the enhanced FSA consumer protection powers recently announced, the importance of such a review cannot be underestimated.

Responses to Specific Consultation Questions

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

Yes. There will be inevitable overlaps between the two regulators, and it is important that both are ready and willing to share information when necessary. To this end it makes sense that both regulators have regards to one another's primary objective.

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

All, namely:

- the need to use its resources in the most efficient and economic way;
- the responsibilities of those who manage the affairs of authorised persons;
- the principle that a burden which is imposed on a person should be proportionate to the benefits which are expected to result from the imposition of the burden;
- the desirability of facilitating innovation in connection with regulated activities;
- the international character of financial services and markets and the desirability of maintaining the competitive position of the UK;
- the need to minimise the adverse effects on competition that may arise; and
- the desirability of facilitating competition between those who are subject to any form of regulation by the Authority.

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

Yes. As regulation becomes more intrusive, financial services firms will become less able to innovate as they are forced to spend a greater proportion of their time dealing with bureaucratic processes. In addition, as new rules come into force asserting that companies must hold more capital than ever before, firms will become less able to reinvest surpluses in people, products or machinery. The CII hopes that, as a consumer and market abuse champion that is tasked with regulating all firms, the CPMA will be well placed to develop the market intelligence necessary to balance competition and innovation considerations, against concerns about conduct abuses and consumer interests.

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

Yes. As alluded to above, the CII thinks that the new regulators should also have regard to public confidence and the need for more professional and ethical standards within financial services via professionalism and ethics in financial services. And, as the CPMA is going to be taking forward consumer protection and the RDR, we feel that it is the best placed body to lead on the professionalism and ethics agenda in promoting a better culture.

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

Yes. The CII particularly welcomes the requirements that the actions taken by the CPMA over the course of a year will be reported to Parliament, and that the CPMA will have to establish statutory consultative panels. It is very important that the body is regularly held to account through public scrutiny, and that the unique insights of professional bodies is taken on board in the CPMA's continual development.

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

Yes. The CII welcomes the retention of all three panels but we think that a review of how the panels are consulted (and resourced) would make sense. We welcome the small business panel being put on a statutory footing.

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

Having one body to co-ordinate fee and levy collection makes sense - hopefully preventing cross subsidies from taking place and making life simpler for businesses. It also makes sense for the CPMA to be entrusted with the role of collector as it is the only body that will be regulating all firms.

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

The current operating model of the FSCS needs to be assessed to ensure the various classes are fair in terms of burden.

Conclusion: Preparing for the Future

It is important that the new regulators are able to prevent or at least anticipate a repeat of the 2008 financial crisis. In our view, however, it is unlikely that future financial crises will be caused by the same mix of factors. Embedded within the new system therefore, must be a proactive systemic approach to identifying various potential economic fault lines and effectively managing them when they appear.

We have argued that part of this proactive approach should be a renewed drive for professionalism and ethics in financial services to improve the culture of financial services firms (and of individual behaviour). A further increase in the number of insurance brokers and financial advisors that properly understand the risks associated with financial products, and who communicate these risks appropriately to consumers will ultimately help to decrease the chances that financial instruments fail and consumers and businesses lose out. We hope that in changing the architecture, the regulators do not lose the momentum gained on projects that embody this ethos, such as the RDR and Solvency II.

We have also argued that alongside financial stability and conduct of business considerations, the new regulators must also acknowledge competition concerns. In this regard, the Government must ensure that the administrative costs to firms of complying with intrusive regulation is limited and does not put at risk the sustainability of UK SMEs. By way of an innovative solution, we have developed the possibility of a regulatory dividend for firms that consistently meet rules on professionalism and ethical business behaviour.

Finally, we have emphasised the different risks posed by banking and insurance and highlighted the separate strands of international regulation currently in the pipeline. To this end we have argued strongly against a one size fits all regulatory environment, which we worry may result from the immense power and governance structure currently proposed for the FPC. In response we ask for more transparency at the FPC through increased public scrutiny and greater Treasury involvement in designing policy measures aimed at preventing future crises. We propose that firms that are proven to adopt enhanced professionalism and ethics in their corporate culture and day-to-day activities should be afforded some sort of concessionary treatment by supervisors.

We believe that embedding such a regulatory dividend can form part of the FSA's (and successor bodies) new recognition of the importance of culture and behaviour of individuals and firms. We also think this step is consistent with the Coalition's pledge to *"end the culture of tick-box regulation and instead target inspections on high-risk organisations through co-regulation and improving professional standards*". This, we argue, will tackle some of the faults of the past system and incentivise appropriate behaviour and culture and, ultimately, improve public trust and confidence.

Appendix 1: CII Member Survey

In August this year, we conducted a survey of our members in an attempt to understand how they view the latest proposals for regulatory change. A total of 2,017 members responded. Key headlines and detailed findings are shown below:

Headlines

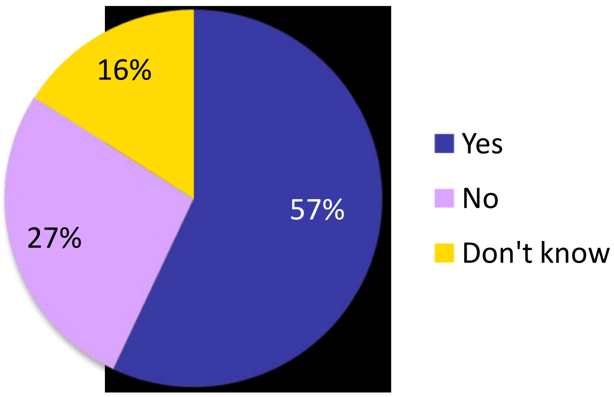
- In general members support the Coalition Government's plans for regulatory change – in terms of the need for change.
- However there are significant numbers who question whether change will lead to an improved system and whether the timetable is realistic. There was greater scepticism from general insurance members. This could be as a result of a fear that the new system will have a heavy banking focus.
- The majority believe that the FSA's new „intrusive' regulation will continue under the new system – though there is also a number who are unsure.
- Members also believe that the FSA should work closely with professional bodies to promote & police ethics.

MEMBERS SUPPORT THE NEED FOR CHANGE

Q1 Do you believe such a major reorganisation is required or would you have preferred less major changes to the current tripartite system?

- Of those members who expressed an opinion, twice as many were in favour of the need for major change to the tripartite system than those who were not.
- Over half (57%) believe that a major reorganisation is necessary. A quarter (27%) of members say they would have preferred less of a significant change.

Overall CII Group results

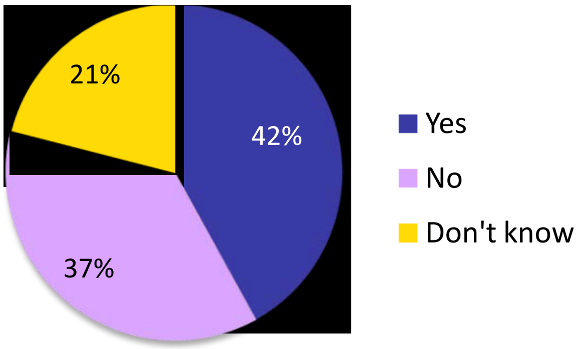


MEMBERS UNSURE OF WHETHER CHANGE WILL PROVIDE IMPROVEMENTS

Q2. Do you think that the regulatory uncertainty and upheaval these changes will create will be worth it to improve the current regulatory system?

- There are similar levels of support for the opposing views of whether or not the upheaval of the proposed changes will lead to an improved regulatory system.
- Members therefore are unsure as to whether the proposed changes will be worthwhile. There are significant levels of scepticism.

Overall CII Group results

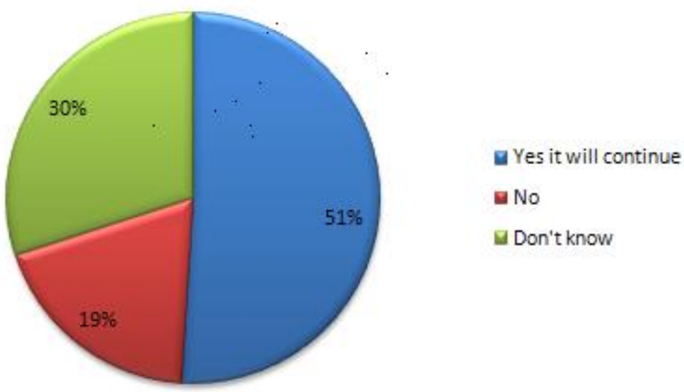


INTRUSIVE REGULATION' SET TO CONTINUE IN NEW SYSTEM

Q3. The FSA has embarked on more 'intrusive regulation'- do you believe this approach will be carried into the new regulatory culture or do you think it will lessen once the new structure develops?

- Just over half of members believe that the FSA's new intrusive regulation will continue under the proposed new system.
- Perhaps significantly there were more who are unsure as to whether it will than those who think it will not.

Overall CII Group results

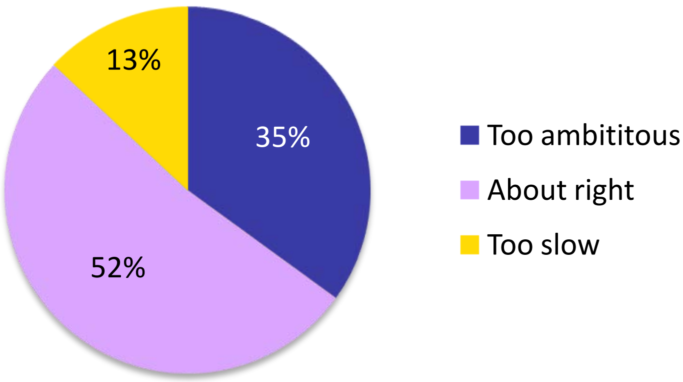


MAJORITY OF MEMBERS AGREE WITH GOVERNMENT'S TIMETABLE

Q4. The government has said it wants the new structure ready by 2010. Is this too ambitious, too slow or about right?

- Over half agree with the proposed timetable for change.
- However, a significant proportion (one third) say that it is too ambitious.

Overall CII Group results

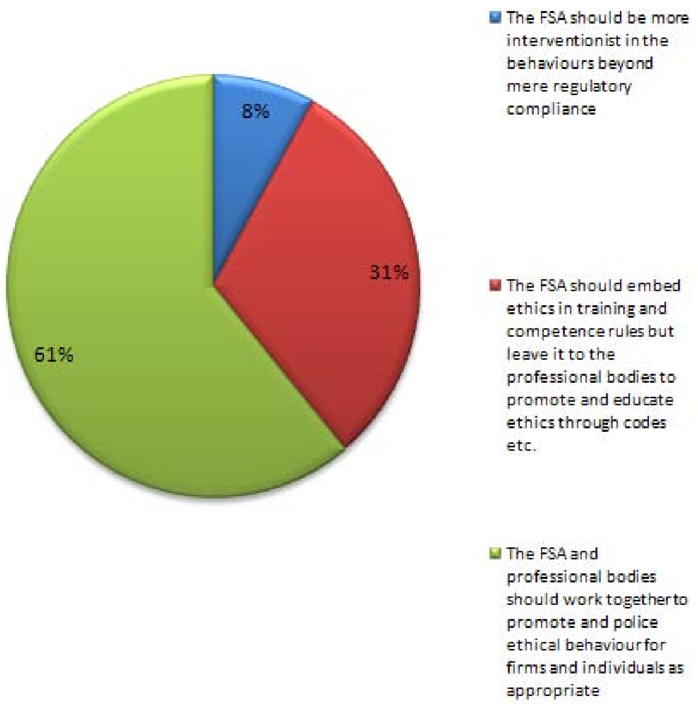


MEMBERS SUPPORT COLLABORATION BETWEEN FSA & PROFESSIONAL BODIES ON ETHICS

Q5. The FSA Chairman raises the issue whether regulators should play a more active role in judging the culture and ethics within a firm. Please choose the option closest to your view.

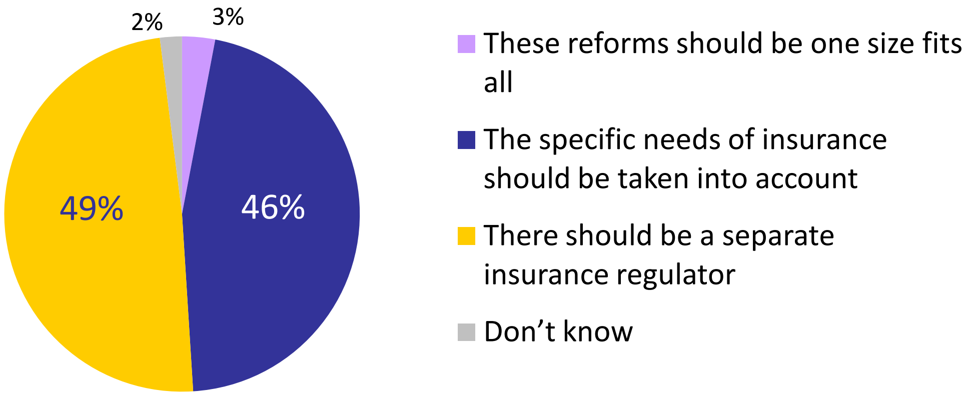
- Almost two thirds of members want the FSA and professional bodies to work together to promote and police ethics.
- Just under one in three feel that professional bodies should be responsible for the promotion and policing but that the FSA should embed ethics in its T&C rules.
- Only a small number support greater intervention on behaviours by the FSA.

Overall CII Group results



CII MEMBERS CALL ON THE REGULATOR TO RECOGNISE THE NEEDS OF INSURANCE

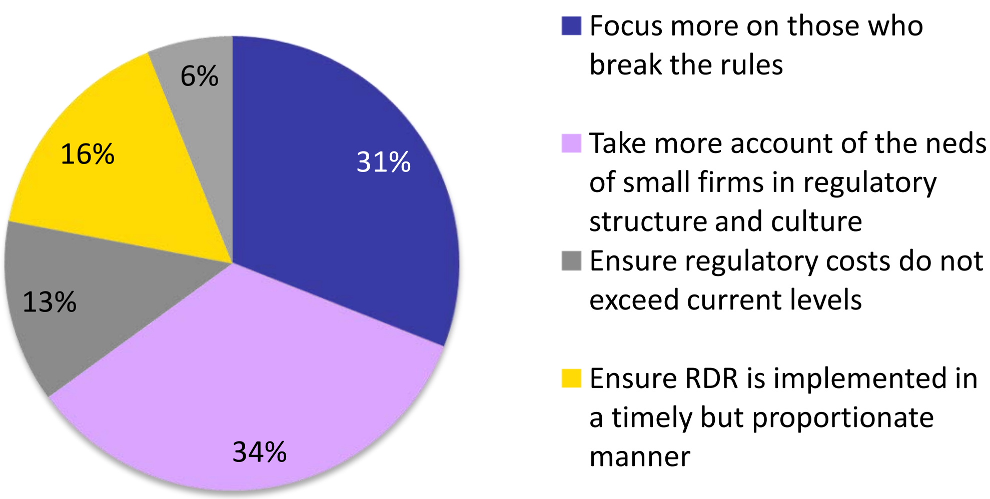
Q6. There has been comments that the proposed reforms were designed to meet failures in banking supervision and do not take into account separate requirements of insurance. Do you believe that...



- 95% of members would like a new regulatory system to take into account the requirements of insurance in some form.
- Almost half of CII members believe there should be a separate regulator (49%).
- A similar number (46%) think that insurance has to be considered during the formulation of a new system but that there shouldn't necessarily be a separate insurance regulator.
- This is a clear message that there is concern that banking could dominate the new regulatory system.

REGULATOR SHOULD FOCUS ON SMALL FIRMS AND RULE-BREAKERS

Q7. What is the most important factor the Government needs to take into account in reforming the FSA?



- PFS members' only question

- A third of PFS members believe that a new regulatory system should better take into account the needs of small firms.
- Almost a third called for more of a focus on those who break the rules.
- Perhaps surprisingly only 16% wanted a timely and proportionate implementation of the RDR.

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CHARTIS

18th October 2010

Financial Regulation Strategy
HM Treasury
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CHARTIS INSURANCE UK LIMITED

RESPONSE TO HM TREASURY CONSULTATION PAPER "A NEW APPROACH TO FINANCIAL REGULATION: JUDGEMENT, FOCUS AND STABILITY"

This memorandum sets out the response of Chartis Insurance UK Limited ("Chartis") to the HM Treasury Consultation Paper entitled "*A new approach to financial regulation: judgement, focus and stability*" published in July 2010 (the "Consultation Paper").

We have had the opportunity of reviewing the response submitted by the International Underwriting Association ("IUA"), of which Chartis is a member. We support the contents of the IUA response. We therefore submit this response in order to emphasise points that are of particular importance to Chartis.

Under the proposed new regulatory architecture, Chartis will be subject to micro prudential regulation by the Prudential Regulation Authority ("PRA") and to conduct of business regulation on its wholesale and retail business by the Consumer Protection and Markets Authority ("CPMA").

We support the proposal to confer responsibility for macro prudential regulation on the Financial Policy Committee of the Bank of England. Whilst this is of more direct relevance to the banking/investment sectors than the insurance sector, we consider that placing express responsibility for macro prudential regulation upon the Bank of England is a positive step.

We believe that splitting firm-specific supervisory responsibilities between two separate regulatory bodies, the PRA and the CPMA, will create potential fragmentation risks that will need to be managed properly in order to ensure effective regulation. In this regard we consider that the following measures will be important:

(a) There must be a clear delineation of specific duties as between the PRA and the CPMA, in order to avoid overlap and duplication of the activities of each body. It must be objectively clear which body is responsible for particular matters.

(b) The rationale for creating the PRA is that a single body should be able to focus on issues that are of importance to the prudential regulation of systemically important firms. There are a number of regulatory responsibilities that could equally be undertaken by the PRA or the CPMA – examples include assessing fitness and propriety of approved persons, supervision of remuneration practices, protection of client money and management of conflicts of interest. In our view such responsibilities ought properly to be conferred upon the CPMA rather than the PRA in order to ensure that the PRA is able to focus exclusively on issues that are of importance to the prudential regulation of systemically important institutions.

(c) It is very important that the PRA and CPMA supervise firms in a properly coordinated and integrated manner. This is for a number of reasons. If the PRA and CPMA conduct supervision in a properly coordinated and integrated manner, the risk of issues "falling between the cracks" or being misconstrued due to a partial understanding of the position will be reduced. Similarly, the risk that the PRA and CPMA take inconsistent approaches to an issue will be minimised. Furthermore, if the PRA and CPMA operate effectively together, the regulatory burden of dual regulation on firms will be reduced, thereby avoiding unnecessary compliance costs (which in turn will be passed on to consumers / shareholders).

By way of example, if the PRA and CPMA are required to conduct joint ARROW visits to dual-regulated firms, rather than separate visits, then this will be of mutual benefit to regulators and the regulated community. Conversely if each regulator conducts separate visits then this will create duplication, inconsistency, wasted management time and increased risk that issues will be missed by both the PRA and CPMA.

As a result we believe that a statutory duty should be imposed on the PRA and the CPMA to act in a coordinated and integrated manner in the supervision of individual firms, where that is appropriate. We have in mind a statutory duty of cooperation similar to that already contained at Section [427] of the Financial Services and Markets Act 2000. It would also be desirable to facilitate a properly coordinated and integrated approach if the two bodies were located physically close to one another.

(d) In order to supervise insurers properly it will be important for both the PRA and the CPMA to have a detailed knowledge and understanding of the insurance sector. To ensure that the current insurance focus within the FSA is not lost or diluted, we would encourage the creation of a number of sector-specific regulatory groups (including, but not limited to, the insurance sector) made up of employees of the PRA and the CPMA to collate knowledge of emerging issues in each relevant sector and coordinate regulatory activity in each sector.

We are concerned that the CPMA is to be designed and promoted as a "consumer champion". The CPMA will in fact have a variety of wide responsibilities and roles, well beyond acting as a consumer champion, including prudential regulation of various wholesale firms (such as wholesale insurance brokers and investment managers); conduct of business regulation of all firms encompassing wholesale and retail business; and responsibility for sound operation of the markets. As a result, we think it is improper and dangerous to label the CPMA as a "consumer champion" as this risks encouraging the CPMA to act as an aggressive enforcement-led regulator in the retail arena, at the exclusion of its wider statutory duties.

As regards the powers of the PRA, the Consultation Paper records that the Government wishes to introduce a new more judgement-focused approach to regulation of firms so that business models can be challenged, risks identified and action taken to preserve stability. We do not consider that new statutory powers are necessary in order to facilitate this approach. It is our view that the FSA in its current form already has very wide discretion in practice to get authorised firms to take action (or to restrain firms from taking action) that the FSA considers is appropriate or desirable. This is achieved through a range of discretionary powers conferred on the FSA, for example by using threats of (a) increased capital requirements on firms, (b) the appointment of skilled persons reports, (c) removal of permissions via the Own-Initiative Variation of Permission supervisory procedures, and (d) the commencement of individual and/or firm-based disciplinary investigations. In practice it would be difficult to frame a wider discretion as a matter of statutory power without exposing the exercise of that power to greater risk of challenge by way of judicial review.

Finally we consider that it is important that both the PRA and the CPMA are required to have regard to the international competitiveness of the UK financial services sector when conducting its regulation. This provides an important proportionality check on the activities of the regulator(s), and should be retained in the new regime.

Chartis Insurance UK Limited
18 October 2010

Chris Nealy

European General Counsel.

CHI-X EUROPE

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

18 October 2010

Dear Sir/Madam,

Response to HM Treasury Consultation: A new approach to financial regulation

This letter and annex is Chi-X Europe Ltd's (Chi-X) response to the Treasury's consultation paper on financial regulation strategy. Chi-X is pleased to be able to support the work done by the Treasury in this important area.

Chi-X is a UK FSA authorised securities firm operating a multilateral trading facility (MTF) for the trading of more than 1,300 of the most liquid securities across 23 indices and 15 major European markets as well as ETFs, ETCs and International Depositary Receipts in both a visible order book and the Chi-Delta™ non-displayed reference price order book. Chi-X's low-cost, streamlined operating model is designed to help trading participants achieve ultra-low execution, clearing and settlement costs, and it also provides a low-latency, high capacity trading system. Real-time market data is disseminated at no cost to trading participants.

Since launch in March 2007, Chi-X has handled more than 300 million trades, equating to a total turnover of over €2.0 trillion. In 2009 alone, trading participants saved over €150 million in price improvement. In August 2010, Chi-X ranked as the largest equity exchange in Europe by number of trades and the second largest by value traded according to the Federation of European Stock Exchanges (FESE). Over the same period it represented 27% of all electronic order book trading in UK FTSE 100 stocks and up to 25% of trading in other major European markets.

In the annex to this letter I have included our detailed response to the consultation. We hope that you find these responses useful in your deliberations and look forward to working with you on these issues.

Yours sincerely,

Denzil Jenkins

Director of Regulation Chi-X Europe

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

The primary objective of the FPC should be supplemented with secondary factors. Chi-X Europe (Chi-X) supports the primary objective of the FPC relating to financial stability. However, no objective can be absolute and to do so may place to great a cost on the economy. For this reason we strongly support supplementing the primary objective with secondary factors that the FPC is required to formally consider when discharging its duties.

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

The FPC should consider factors similar to the "principles of good regulation" as described in section 2 of FSMA. Key considerations are:

- Proportionality;
- Efficiency and economy;
- Innovation;
- Competition; and
- International character.

These will ensure that the FPC acts in a measured manner taking account of good regulatory practice in obtaining its primary objectives whilst minimising any adverse effects of its actions.

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

The factors should be considered as 'have regards' as the primary objective of the FPC should be financial stability.

4 The Government welcomes respondents' views on:

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

  Yes, we believe it is vital that the PRA has regard to the primary objectives of the CPMA. There is frequently an inter-relationship between prudential and conduct issues in the supervision of both individual firms and sectors. Both the CPMA and PRA will need to co-operate on these issues. To avoid the possibility of divergent and conflicting actions it is important that both organisations have regard to the primary objectives of each other.

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

Yes. We believe that all the principles of good regulation detailed in section 2 of FSMA should be retained for the PRA. As detailed in the response to question 2 the considerations are matters of good regulatory practice.

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

  Yes. Innovation is important to the development of new products and services which can better service users and maintain the competitiveness of UK financial services. Innovation that is well considered and monitored should not present an undue threat to the PRA's primary objectives. The consideration of the international character of financial services and the competiveness of UK financial services reflects the need to protect the UK's role as a global hub of the financial sector. However, it is a secondary factor and should not override the primary objective. The PRA should also address this through co-operating with other regulators and international bodies to reduce the scope for regulatory arbitrage.

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

  We have no comment.

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

Both the PRA and the CPMA should retain distinct roles. To place one authority with responsibility, for example for authorisation and permissions, would give it undue weight. This will require close co-ordination between the two authorities and it is important that the mechanisms and processes for decision making and arbitration between the two authorities are clear and transparent to regulated firms. This will reduce the risk of deadlock between the two organisations and firms being given conflicting or duplicating instructions. It is also important that timelines and service standards are set to ensure that regulatory decisions are made in a timely and predictable fashion.

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

It is not clear how the approach outlined in the consultation will lead to the PRA taking a more risk-based judgement-focussed approach to supervision. The approach appears reasonable for the transfer of regulatory functions and rule making. It is essential that the rule making functions of the PRA are subject to the same safeguards that currently exist for the FSA, and which should also be applied to the CPMA. This ensures that rules are well considered, benefit from feedback and are seen to have regard to both the primary objectives and secondary factors. In particular this must include the necessity to publically consult on rule changes. Consultation should also include relevant industry, practitioner and consumer panels as appropriate. Detailed market failure analysis and a robust cost benefit analysis should also be retained.

While the rule making of the PRA and CPMA will benefit from the processes described above it is vitally important that these regulators have suitably experienced staff with expert knowledge. Action needs to be taken to ensure retention of suitably experienced FSA staff with expert knowledge and that the regulators are able to recruit and train new high quality staff, in particular those with understanding and experience of the areas they are regulating.

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

Please see the response to question 6 above.

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

Careful consideration should be undertaken to any streamlining of these safeguards where possible to ensure that regulatory decisions and rule making is timely and effective. Emergency powers are available to the FSA, and should be retained for its successor authorities, allowing normal decisions and rule making to be conducted with the appropriate circumspection. The Consultation does not make clear why the Treasury considers that the safeguards be streamlined nor what aspects. It is vital that the safeguards remain in place, and are open and transparent.

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

It is important that both the FPC and PRA work in a transparent and accountable manner. The respective roles of the FPC and PRA need to be clear. As the Consultation acknowledges, it is important that the strong link with the Bank of England (the Bank) be balanced by an independent board. It is necessary to have NEDs with suitable expertise and authority to fulfil this. The expertise and views of the regulated firms should also be represented in the round on the board of the PRA. It is unclear why the PRA should have a different governance structure from that of the CPMA. We also welcome Parliamentary scrutiny, including of the PRA and CPMA executives and boards through the Treasury Select Committee.

To ensure that the respective roles of the CPMA are appropriately represented on the board of the PRA the head of the Markets unit of the CPMA should also sit on the board of the PRA. This is particularly appropriate given the importance of wholesale financial markets to prudential regulation.

10 *The Government welcomes respondents' views on:*

- *whether the CPMA should have regard to the stability of firms and the financial system as a whole, by reference to the primary objectives of the PRA (Prudential Regulatory Authority) and FPC (Financial Policy Committee);*

  Yes. We believe that it is important that the CPMA has regard to the general obligations of the PRA and FPC and vice versa. The regulatory authorities should be consistent with each other.

  An additional consideration is the impact any conflict will have at a European level. The proposed regulatory structure will mean that only the CPMA will sit directly on ESMA. The CPMA having regard to the stability of firms and the financial system as a whole, by reference to the primary objectives of the PRA and FPC, will ensure that it is better placed to represent all UK authorities on ESMA.

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

  Yes. We believe that all the principles of good regulation should be retained for the CPMA. They remain relevant for the CPMA and as 'have regard to' represent a balance on the primary objective.

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

  Yes. Also see the response to Question 4.

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

  The CPMA should have regard to broader public interest considerations, in particular, helping to educate the public about the role of financial services and encouraging more active retail participation.

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

We are broadly supportive of the proposals in the Consultation, including that the Board of the CPMA is composed mainly of non-executive members and the CEO of the PRA will also sit on the Board.

Given the importance of the two respective parts of the CPMA we consider that the Markets and Consumer units should be of equal weight in the organisation. The membership of the CPMA Board must be balanced to represent equally the two functions of the CPMA, consumer and markets. In this respect, consideration should also be given to having a distinct Chief Executive of each unit, Consumer and Markets, under an executive Chairman of the CPMA who represents the whole organisation. As referred to in the response to question 9 the head of the Markets unit of the CPMA should also sit on the board of the PRA.

The CPMA will represent the UK at ESMA and it is therefore critically important that it commands the appropriate authority and can recruit and retain appropriate staff, including at a senior level. In particular, the Markets unit will play a key role in the interaction with ESMA and the measure set out above will assist in the ability of the Markets unit to have a credible voice within ESMA.

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

In addition to the proposed statutory panels, a Markets Practitioner panel should be established for the Markets unit including participants from the major exchanges and trading platforms ("Organised Markets"). We believe that Organised Markets form an important part of the financial services sector and that the existing proposed panels will not adequately represent these interests.

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

We agree that the CPMA should collect fees on behalf of the other regulatory authorities and associated bodies. This should avoid duplication of work by having each body perform this function for itself. However, we wish to emphasise the importance of the fee setting process being transparent.

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

We have no comments.

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

We are concerned about the potential detrimental effects of splitting responsibility for markets and infrastructure between the Bank of England (for CCPs and settlement systems) and the CPMA Markets unit (for exchanges and trading platforms). There is the potential for a lack of co-ordination on the supervision and policy making for exchanges/trading platforms and infrastructure providers, loss of focus on the conduct aspects of infrastructure providers by the Bank, increase in the overall costs of regulation, and the reduction in the UK's voice in the European regulatory environment.

Co-ordination

By splitting the regulation of Organised Markets and OTC markets and participants from the regulation of CCPs and settlement systems, there is a danger of a lack of co-ordination between the regulatory bodies. Organised Markets, CCPs and settlement systems form different parts of an intrinsically linked value chain. Many of the risks faced by the organisations are the same. Given that co-ordinated regulatory oversight is now generally regarded as being critical to preventing systematic risks similar to those that occurred in late 2008, splitting the regulatory responsibility in this way could potentially be a step in the wrong direction. We recognise the role of the Bank in considering prudential aspects and settlement risk. If the infrastructure is going to be regulated by the Bank there must be effective mechanisms for co-ordination with the Markets unit of the CPMA.

Conduct aspects of Regulation

We are concerned that due regard be given to the conduct aspects of infrastructure regulation. In particular, issues such as fair access and competition are a crucial element of the current environment and the regulatory regime must be designed to take this into account. Given the PRA's focus on financial stability, there is a risk that these considerations will be given insufficient emphasis.

Cost

Economies of scale that exist by having regulatory responsibility in one organisation are likely to be lost. This is likely to mean increased costs for the industry in terms of financing the regulatory regimes. The PRA and the CPMA must have an objective to reduce the duplication of overhead and costs where possible.

Voice in Europe

The division of the FSA into two authorities risks reducing the UK's voice in ESMA. ESMA will have European responsibility for policy and other aspects of the supervision of CCPs. As the CPMA will represent the UK at ESMA, the Bank having lead responsibility for the supervision of CCPs will reduce the effectiveness of the UK contribution to ESMA in this regard unless appropriate arrangements can be made.

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

Chi-X agrees that rationalisation may be advantageous for the following reasons:

The Recognised Body ("RB") regime is no longer required: As is set out in paragraph 5.13 of the Consultation exchanges used to have some regulatory functions and act as Self Regulatory Organisations, including the Listing Authority and in many aspects of member compliance and market abuse. These functions have subsequently largely been taken over by the Statutory Authority. The Recognised Body regime is an anachronism of the previous state of affairs.

Consistency of regulation: Entities which carry out similar functions should be subject to equivalent regulation. There is the scope for significant difference in regulatory requirements and distortion of competition between operating two regimes to cover what are essentially similar activities. In particular, RBs are not covered by the same obligations as authorised investment firms including firms operating MTFs in respect of Approved Persons (although the FSA has sought to apply this on a voluntary basis), capital resources, Remuneration Code and permissions. The RIEs have frequently made a case for equivalent regulation for equivalent functions and as such should support one regime.

Efficiencies: Establishing and maintaining one regime would provide for considerable regulatory savings.

Powers of the regulator: As the RB regime was intended for entities with significant SRO functions, it is relatively high level and provides the regulatory authority with few powers. As the SRO functions of RBs have disappeared and they have become for profit entities operating in a competitive environment they no longer act in a quasi public authority manner. This increases the need for the regulatory authority to have effective powers to be able to ensure compliance with the regulations. The RB regime only provides the draconian powers of direction and de-recognition. Given the difficulties in using these powers the FSA has never used them. The authorised firm regime has considerably greater powers which are also graduated allowing them to be a proportionate and credible deterrent. For example, s.166 reports, OIVOPS and fines.

The merits of having one regime were acknowledged by the FSA in its Discussion Paper "The FSA's approach to regulation of the market infrastructure" (2000) should the market structure become more competitive and multi-venue. This has now occurred.

In the event that the Recognition Regime be retained then this should be opened to allow Organised Markets, such as Chi-X Europe, to become Recognised Investment Exchanges without having to list equities. This will allow competition to occur on a level playing field.

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

Alignment of functions between the UKLA and the CPMA: We do not believe that the UKLA should be separated from the Markets unit of the CPMA for the following reasons:

The functions of the UKLA generally relate to wholesale securities markets and investor protection which is aligned with the activities of the CPMA. The UKLA is a regulator of securities not companies. The UKLA also has to act in a timescale related to securities markets and including real time supervision of disclosures. It is also required to act on the enforcement of its rules. The FRC is responsible for developing corporate governance for UK corporates, it does not undertake real time monitoring. Only a small proportion of the securities under the UKLA are subject to the FRC. The UKLA also provides a key investor protection role which more closely sits with the functions of the CPMA.

The CPMA will represent the UK on ESMA: In most other European jurisdictions the listing authority is part of the financial services or securities regulator. ESMA will be involved in the discussion at a European level of the functions covered by the UKLA. Its inclusion will also give the Markets unit critical mass in its ability to recruit and retain staff, including at a senior level.

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

We do not believe that this is the case. The Panel on Takeovers and Mergers (POTAM) is responsible for the conduct of takeovers, regulating companies, bidders and advisers. There may be scope for POTAM to be part of the CPMA.

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

We have no comments.

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

We have no comments.

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

We have no comments.

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

The impact assessment does not give due regard to the potential effect of the proposals on:

- the potential duplication of costs and loss of economies of scale from the separation of the functions of the FSA into two separate bodies;
- A reduction in the UK's ability to continue to influence EU policy development due to the likely focus on the domestic structure and potential diversion from representing the UK's interests during a period of major EU regulatory change.

Evidence

Citizens Advice response to the HM Treasury consultation: *A new approach to financial regulation*

October 2010

Introduction and summary

Citizens Advice welcomes this opportunity to respond to this HM Treasury consultation *A new approach to financial regulation*. The Citizens Advice service is a network of over 400 independent advice centres that provide free, impartial advice from more than 3,000 locations in England, Wales and Northern Ireland. In 2009/10 the CAB service dealt with over a million problems relating to consumer credit agreements, 115,000 issues relating to mortgage and secured loan arrears and over 140,000 non-debt related enquiries relating to a broad range of financial services. We believe that this experience makes us well placed to comment on the problems faced by consumers entering markets for retail financial services and credit and related products in particular.

As a consumer advice, education and advocacy organisation Citizens Advice is mainly concerned with the questions in this consultation that relate to the proposed Consumer Protection and Markets Authority (CPMA). Therefore we have limited our response to the Chapter 4 questions on the CPMA.

On outline summary of our key views and concerns would be:

- Citizens Advice strongly supports establishing the CPMA as a strong consumer champion.
- We believe that the CPMA's consumer protection objectives should be independent and not junior to the prudential regulation objectives of the FPC and PRA
- We believe that the CPMA board should be constituted to ensure that the consumer interest is the majority interest for the CPMA.
- We would like to a clear route for consumer groups to raise emerging significant problems with CPMA and the CPMA to be placed under a duty to remedy significant consumer problems as completely as practicable within a specified timeframe.
- We believe that the CPMA needs to develop an effective consumer engagement and advocacy strategy to ensure that consumer voices and concerns are heard at the heart of the regulatory regime.
- We would like to see a strong emphasis in preventing consumer problems embedded in the CPMA's objectives
- We would like to see the CPMA given a clear duty to ensure that all consumers are able to benefit from retail financial services in key areas. The CPMA should develop a concept of key financial needs as the basis for ensuring suitable and accessible products are available for all consumers. Transactional banking, suitable credit products and income protection would be non exhaustive examples.
- We believe that the CPMA should have a particular focus on protecting the interests of vulnerable consumers and consumers from minority groups
- We believe that the CPMA should be empowered to deal with competition issues in retail financial services markets to ensure that consumers get good value for money.

General comments

Citizens Advice warmly welcomes the government's intention to establish the CPMA as a strong consumer champion.

In recent years the CAB service has dealt with a succession of widespread consumer problems with financial products and services including payment protection insurance, bad practice in sub-prime mortgage markets, irresponsible lending of unsecured credit and the ongoing saga of bank charges. We continue to see cases of consumers suffering often-severe detriment in each of these areas.

As a result, we firmly agree with the statement in this consultation that the Financial Services Authority has not always adequately protected consumers. The FSA has in the past failed to act quickly enough or decisively enough to prevent large numbers of consumers experiencing often severe detriment. That said the FSA has recently updated its approach; focusing on outcomes and developing a more interventionist and pre-emptive approach to regulation. The retail conduct strategy appears to be moving away from an over-reliance on disclosure as the main consumer safeguard to a more rounded and complete view of the causes of consumer problems.

Citizens Advice welcomes these developments and agrees with the point made in the consultation that this is a good starting point to build on. But we are also clear in our belief that the establishment of a new consumer champion provides the opportunity to think afresh about the objectives, structures, duties and powers that the CPMA will need to fulfil this mandate.

We have set out an outline view on what key elements of this might be in our responses to the questions in Chapter four as follow.

Question 10

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

This consultation on the CPMA starts with HM Treasury's analysis that the consumer protection objective should not be in tension with prudential regulation objectives. Citizens Advice agrees with this point to the extent that we believe that the consumer protection objective should not be subordinated to the primary objectives of the PRA and the FPC.

While the CPMA might *have regard* to the prudential objectives, there is a clear potential for exactly the tensions that this consultation describes if the consumer protection objective is to be restrained or subdued by the suggestion that a regulatory intervention might undermine the financial stability of a firm or firms.

We do not believe that this is likely to be a purely theoretical concern. At least two recent widespread consumer problems (the bank charges test case and PPI redress) raised the possibility of the FSA organising consumer compensation on a very large scale. For instance, the recent FSA policy statement on payment protection insurance complaints and redress gave an estimated cost of the package of remedies as between £1.2 billion and £3.2 billion.

This highlights the extraordinary scale of consumer detriment that can arise from widespread problems with retail financial services. Given this, a firm, firms or sector heavily exposed by bad practice might argue that the scale of the redress requirement could force them to raise capital or exit the market (as the FSA believes will be the case for some intermediaries and secured lenders under PPI redress proposals). It would be a perverse consequence if larger firms were able to argue that consumer redress should be reduced or delayed on grounds of financial stability.

We would also wish to raise a concern about the way in which policy aimed at macroeconomic stability could impact upon the objectives of the CPMA. We set an outline argument above that we believe that the CPMA should have an objective ensuring access to suitable financial products for vulnerable or financially marginal consumers.

Given the concerns set out in the government credit and debt review on high cost credit, interest rates and bank charges, we would argue that ensuring access to suitable and affordable credit products might fall within such an objective.

However, Chapter 2 of this consultation describes a number of macro-prudential tools that might be used to dampen down the credit cycle. Citizens Advice would support measures that discourage unsustainable lending practices as we believe that this will have a positive impact on consumer debt problems. But we believe that there is a danger that these high level macro tools could result in credit products being withdrawn from lower income consumers; not necessarily because they pose any significant extra credit risk but because suitable credit products that meet their needs will have higher opportunity costs in a market framed by credit rationing.

For both the above reasons, we believe that the way conduct and prudential regulatory approaches relate to each other is likely to need careful thought. Citizens Advice would argue that the first and most important task for reform of financial services regulation is to set clear expectations about the way that this market will treat consumers in the future. The experience of the credit crunch shows us that retail financial service sector recovery must have a firm foundation in public (and in particular consumer) trust.

Therefore we believe that the key objectives of the CPMA should not be subordinated to the macro and micro prudential objectives of the FPC and PRA. If anything, we believe that the relationship should run the other way round, with the objectives of the CPMA setting the key ethical and social outcomes for financial services markets around which prudential regulation works.

Whether some or all of the principles for good regulation currently set out in section 2 of FSMA should be retained for the CPMA…

Quick and complete responses to widespread problems

Citizens Advice supports principles aimed at efficient and effective regulation. As such we would broadly support the first three points listed in paragraph 4.10 (corresponding to section 2(3) a],b] and c]). However we believe that there are two key omissions form the 'have regards to' list in respect of proportionality and effectiveness.

Firstly, there is nothing in the principles of good regulation requiring the regulator to deal with consumer problems quickly or to remedy detriment as completely as is practicable. These should be key concerns for a consumer champion focused on conduct of business issues.

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

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

Act require the Competition Commission to do this within two years of a market investigation reference – a year might be a suitable timeframe for the CPMA.

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

Meeting the needs of vulnerable consumers and consumers with protected characteristics

Secondly we believe that the requirement to ensure that burdens and benefits are proportionate should be modified to ensure that the needs of vulnerable and consumers and consumers from minority groups are properly addressed. A basic principle of equalities policy is that people with certain shared characteristics (protected characteristics in the Equality Act 2010) should not suffer less favourable treatment as a result of these characteristics. In the case of disability, Equality law requires firms to make reasonable adjustments to avoid disadvantage.

Users of financial services with protected characteristics, or indeed with other shared characteristics such as low incomes or low levels of financial capability, might need interventions and adjustments to ensure that their needs are properly meet. However people with particular characteristics might well form a minority, even a small minority, of those consumers using a particular financial service. In which case the costs of any proposed adjustment (such as a system change) could outweigh the benefits on a ‘cash for cash’ basis.

But this should not by itself be a barrier to action by the regulator. Citizens Advice believes that the CPMA should be empowered to intervene as necessary to ensure that the needs of specified groups of consumers are being met as the broader social benefits of fairness and inclusion will otherwise be undervalued.

This could be achieved in legislation by:

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

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

Citizens Advice believes that these sub-headings of section 2(3) should to be remodelled.

Firstly we do not believe that either arguments about innovation or the competitive position of UK firms vis-à-vis non-UK firms should subordinate or undermine the CPMA’s consumer protection objective.

Secondly, we would only support the principle of facilitating innovation where such innovation can be seen to provide an unambiguous benefit for consumers. We often see cases where supposed innovation adds layers of unnecessary complexity onto financial products that mean consumers are more likely to be sold something that is unsuitable for their needs.

Payment protection insurance provides one example of a product sector where a huge diversity of product features makes it more difficult for consumers to weigh different products for value while providing little additional consumer benefit.

Another example where we are starting to see evidence of product complexity causing consumer detriment is with packaged personal current accounts where the transactional banking facility is bundled with other products and services such as insurance. This innovation might provide considerable benefit for some consumers, but for others it has become a new source of mis-selling problem.

> A CAB in Lancashire saw a 36 year old woman who had learning difficulties. She was in receipt of disability living allowance and means tested benefits. She had difficulties dealing with debts including a bank overdraft . Her bank had persuaded her to open a 'packaged account' that charged a monthly fee and provided associated insurance benefits. The woman did not understand why the monthly fee was being taken out and she did not need any of the insurance cover nor had she used the cover. She did not have enough money in her account to cover the fee and was offered an overdraft. The debt spiraled to £427 and was passed by the bank to a debt collector.

It is clear that in financial services there can be a real tension between product innovation and consumer protection. Therefore we believe that the principle of good regulation requiring the FSA to have regard to the desirability of facilitating innovation should not be carried over to the CPMA in the same form.

Competition concerns

The last two heads of section 2(3) require the FSA to consider competition, but only in the context of considering whether any regulatory intervention might reduce competition. We believe that this is problematic for two reasons.

This principle creates another potential tension with the consumer protection objective. Competition may fail to provide clear price and quality signals for consumers, particularly where there is a profusion of product complexity such as with the PPI market. In which case an intervention by the regulator to require better and clearer price and quality signals (including by directly influencing product design and price) could provide a better outcome for consumers. We understand that the OFT made such an intervention to facilitate common definitions across critical illness insurance products. We believe that such an approach could have produced better consumer outcomes with PPI.

So in some cases the right solution to consumer detriment might be for the regulator to intervene as a substitute where competition is failing to provide optimum benefits for consumers.

We also believe that these parts of section 2(3) are problematic because they do not actually empower the FSA to act as a competition regulator for financial services. It seems incongruous that the CPMA, as a consumer champion, must have regard to the effects of its own actions on competition, but not be empowered to address any features of financial services markets that have an adverse effect on competition.

Citizens Advice believes that the CPMA should be empowered as a price regulator in the sense that it should be able to intervene to ensure that consumers get good value for money from financial goods and services.

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

Citizens Advice believes that the current consumer protection objective in section 5 of FSMA needs to be updated to reflect the role of the CPMA as a strong consumer champion. The current duty is vague in its purpose and, in requiring protection to be 'appropriate', indeterminate in its force. It also fails to clearly set out the broader public interest objectives that we would expect of a consumer champion.

Therefore we believe that the consumer protection objective should be expanded to clearly establish core aims of the CPMA. We believe that these should be parallel objectives rather than 'have regard to' principles. In addition to the duties set out above (remedying consumer detriment quickly and completely, protecting vulnerable consumers and ensuring consumers get good value for money), we believe that this should include:

- Preventing consumer detriment from occurring in the first place by anticipating the causes of consumer problems
- Ensuring that the market works well to meet the financial needs of all consumers.

Preventing consumer problems

Previous approaches to consumer protection have focused on disclosure of key information to consumers and *after the fact* enforcement action in respect of any breach of rules and principles. While both these approaches are and remain key, we do not believe that they will ever be sufficient to prevent consumer detriment by themselves.

Approaches based on product information will always be limited because consumer detriment can be embedded in the way that products are sold, the way that the relationship between the firm and consumer unfolds over time and also in the way that products are designed and brought to market.

Likewise, we believe that effective enforcement and collective redress are vital tools to protect consumers and deter bad practice. But they both have a *second best* character in that they are trying to put right consumer problems that have already happened. A better approach would be to try to ensure that serious consumer problems do not happen in the first place.

We believe that this preventative approach should be a key aim of the CPMA. To deal head off consumer problems before they arise the CPMA must be prepared to intervene at all stages of the product cycle including the way that products are designed. Working with firms to spot the features of products that could cause consumer detriment and pre-empting these before they come to market is a better approach than just relying on enforcement and redress to clear up after a mess. The FSA retail conduct strategy is starting to outline such an approach , but we are not sure that this has yet crystallised into a fully formed objective. Therefore we believe that this approach must be developed by the CPMA. A clear commitment to preventing consumer problems should form a key part of its consumer protection objective.

Ensuring that the market works well to meet the financial needs of all consumers.

We believe that the CPMA, as a strong consumer champion, should be empowered and expected to intervene not just to protect consumers against conduct and other market failures, but also to ensure that consumers have reasonable access to products and services that are suitable for their needs. The increased emphasis on product design in the current FSA Retail Conduct Strategy is very welcome. But the CPMA must build on this and take steps to both influence and, if necessary, prescribe what firms should bring to market as well as what they should not.

To guide this objective, the CPMA should develop a concept of key financial needs as the basis for ensuring suitable and accessible products are available for all consumers. Transactional banking, suitable credit products and income protection would be non exhaustive examples.

We believe that this approach is necessary because competition in retail financial services markets has not always worked to the benefit of all consumers. For instance competition in unsecured credit markets may have driven down headline interest rates, but this was in part funded this through very high commissions on PPI products sold disproportionately to lower income consumers. Likewise, the OFT market investigation into personal current accounts showed how the benefits of 'free in credit' banking for consumers is partly paid for by the often eye-watering bank charges levied on poorer consumers, some of whom get trapped in a cycle of debt-charges-debt.

But such unfair and unhealthy equilibriums may not be unpicked to the benefit of more vulnerable consumers by even robust conduct of business alone. Firms may exit the market (as we are seeing with PPI) or may discontinue or restrict services to more marginal consumers. An intervention to deal with market failure may succeed at the cost of producing a 'missing market' for some consumers who become more financially excluded as a result.

Therefore we believe that the CPMA should have a clear and well developed objective to ensure that, as far as is possible, there is no patterned or systematic exclusion of any group of consumers from financial goods and services markets and that goods and service are available that take account of their specific needs.

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

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

Citizens Advice believes that it will be crucial to get the governance of the CPMA right if it is to operate consistently as a strong consumer champion.

Key elements in developing a system of governance that is fully responsive to consumer concerns would include the following:

- As a strong consumer champion, the CPMA board must be constituted to ensure that the consumer interest is the majority interest of the CPMA.
- In addition we believe that the CPMA needs to develop an effective consumer engagement and advocacy strategy to ensure that consumer voices and concerns are heard at the heart of the regulatory regime. This means ensuring that the CPMA talks to consumer advocacy groups fully and often. It also means developing a strategy for the CPMA to engage with consumers directly. As a strong consumer champion the CPMA needs to be more than an umpire standing between consumers and the financial services industry. Instead it needs to work hard to understand consumer concerns, needs and problems and then work harder to ensure that the retail financial services sector changes to take better account of these where necessary.
- The CPMA needs to be more transparent in its dealings with consumers. This means being prepared to publish full details of reviews and research – not just one page summaries. It also means alerting consumers to problems in the market and problems with particular firms earlier and better than is currently the case.

Citizens Advice would support retaining the consumer panel As we believe it plays a very important role in mediating between consumer concerns and the technical detail of financial services regulation. But good as the consumer panel is, it is no substitute for the governance and consumer advocacy points set out above.

We have no objection to retaining the practitioner panel or to putting the small business practitioners panel of a statutory footing.

Question 13 – Funding arrangements.

Citizens Advice has no particular comment in response to this question. We have no objection to the CPMA continuing to collect fees.

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

On balance our preference would be for the FSCS to remain as a single scheme. This provides a simpler message for consumers. It also avoid the possibility of different firms within a single sector being covered by different guarantees (for instance deposit taking mortgage lenders and non-deposit taking mortgage lenders). Here we presume that the CPMA would continue to set key threshold conditions for firms in relation to conduct risk (such as requirements for indemnity insurance, or bonds or sufficient capital to guarantee consumer claims against misconduct). In which case it would seem to make sense to keep the conduct threshold conditions and decisions about FSCS together at the CPMA.

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Submission of the City of London Law Society's Company Law Sub-Committee in response to HM Treasury's consultation on the new approach to financial regulation

The City of London Law Society ("CLLS") represents approximately 13,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees. This response in respect of HM Treasury's consultation on the new approach to financial regulation and has been prepared by the CLLS Company Law Committee. The Committee's purpose is to represent the interests of those members of the CLLS involved in company law and related regulation.

Overview

By way of background, we think it is important to note that the wider Treasury review is a response to challenges and problems arising out of the financial crisis. However, in our view market regulation in the UK worked well during the financial crisis and on issues such as market abuse and short-selling, the ability of one regulator (the FSA) to consider and address the relevant points (a classic example of an integrated primary/secondary market issue) was very important and contributed to effective and very timely action, where the UK demonstrated that it was at the forefront of the global response. We are concerned that to separate the UKLA from the regulator with primary responsibility for the regulation of the capital markets risks a reduction in the efficiency of UK market regulation and the capacity of the system to respond to future crises.

Anything which makes capital raising in the UK markets for UK companies less effective and less attractive with no compensating regulatory benefit seems to us misguided.

We suggest that any decision on this aspect of the architecture of financial regulation in the UK should be tested against the following objectives:

- to ensure that the UKLA is able to maintain and enhance its reputation as an effective regulator of the primary capital markets in the UK, sensitive to commercial and market realities, while at the same time ensuring that high standards of behaviour are achieved.

- to ensure that the UK has a strong voice in ESMA on matters of primary market regulation, able to influence future policy and rule making in a way that will allow the capital markets in the UK to retain their leading position.

Combining the UKLA and the FRC

A threat to regulatory effectiveness

We understand that this proposal is motivated by a desire to join more closely the governance and financial reporting and disclosure role of the FRC with the governance and wider disclosure role for listed companies of the UKLA. We acknowledge that there is some area of overlap but in our view that area of overlap is relatively small.

On the other hand we see major risks if the UKLA, as regulator of primary market activity, is separated from the regulator of secondary market activities (the CPMA).

In essence our concerns stem from the significant loss of synergy and effectiveness that we foresee from this separation. The inefficiencies we see will be exacerbated because there will be three market regulators, since the PRA will have responsibility for certain market regulation deemed to cover prudential/systemic risk issues. It is inevitable that moving primary market regulation away from the market expertise and real time information flow that will remain with the CPMA will lead to a serious risk of gaps falling between regulators and accordingly less effective regulation, potential areas of duplication and potential areas of inconsistency of approach. In stark contrast, it is clear that placing the UKLA with the secondary market regulator within the CPMA would facilitate cross-team communication and interaction, which would be likely to lead to better regulation which would be of benefit to both market users and companies. Overlaps between primary and secondary market regulation permeate almost all transactions and market activity. For example the application and enforcement of the market abuse regime in relation to secondary market activity interrelates integrally with the adequacy and timeliness of primary market/DTR/UKLA disclosure regimes.

In addition we do not see any fit between the FRC with the substantial bulk of work of the UKLA. The FRC's responsibility extends only to UK companies while the bulk of the UKLA's activities relate to securities issued by non-UK companies (currently only about 6 per cent of the securities admitted to listing by the UKLA are shares of UK companies). The UK's principal work involves:

- reviewing and approving documentation for capital markets issuances, frequently on an urgent basis, predominantly for debt and securitised derivative offerings, in numerous cases for non-UK issuers; and

- enforcement based on extensive market monitoring structures and market sophistication.

We see no synergy in this area with the work of the FRC. On the contrary, we see potential inefficiencies by combining organisations with such different roles.

The UKLA's voice in the ESMA

We have serious concerns about the effect of the proposal on the communication of the UK's views on primary market regulation issues to the ESMA, where the UK will have only one seat. Most of the roles of UKLA involve the application of EU directives and regulations and the EU is likely to be the primary mover of further regulatory changes in this area. If the UK primary markets are to remain successful it is essential that there is a strong voice able to influence regulatory developments in Europe. We have serious concerns that a sidelined UKLA will be unable to provide that voice.

The involvement of the UKLA and wider FSA expertise directly in discussions about proposed and existing EU legislation has been crucial in making sure that, so far as possible, the relevant legislation works in the UK market and, whilst protecting investors does not disproportionately impact on the UK's competitiveness. The continuing EU reform agenda around the Prospectus, Transparency and Market Abuse Directives together with the clear pressure for increased harmonisation of the application and enforcement of rules means that strong and coherent representation of the UK's interests on ESMA is critical.

Companies Regulator

We oppose the idea of creating a new companies regulator.

While it might be possible to present a combined FRC/UKLA as a regulator with responsibility for the whole range of reporting and disclosure obligations, from financial reporting to periodic narrative reporting (including governance) and ad hoc market disclosures, we see no advantages in such a construct and the significant risk that doing so would send a signal that these are matters that for UK companies demand tighter and more interventionist "regulation". We are concerned this would significantly reduce the attractiveness of the UK and its capital markets with consequent damage to the UK economy.

19 October 2010

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15 October 2010

Dear Sirs

CM 7874: A New Approach to Financial Regulation

The City of London Law Society ("**CLLS**") represents approximately 13,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees. This response 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.

The Committee would like to comment on certain issues and questions raised in the Government's consultation on reforming the UK's financial regulatory architecture.

We start (somewhat reluctantly, as will be apparent from our more detailed comments following) from the premise that the high level structural reforms which have been proposed by the Government, namely the creation of the FPC and the transfer of the FSA's existing regulatory functions and responsibilities to, principally, two new regulatory authorities, is a fait accompli in the sense that it reflects a political policy decision taken in the run-up to the recent election and re-affirmed shortly thereafter. This premise is reflected by the nature of the questions posed in Annex A to the consultation document.

We shall not therefore comment further on that 'macro' aspect of the proposals.

The comments which follow do not in all cases address specific questions set out in the consultation, but where relevant we have noted the questions to which our comments are most pertinent.

1. The division of responsibilities and coordination of processes (Questions 5)

Our main concern (a concern which also informs many of the more specific points made below) is that the consultation document underestimates the difficulties of unpicking and dividing up the present legislation (principally FSMA itself, but also including the Regulated Activities Order and the FSA's rules made under FSMA) and distributing responsibilities for the various elements between the PRA and the CPMA; and overestimates the virtues of what is referred to as the "collegiate" solution to the supervision of institutions subject to the jurisdiction of both authorities.

We observe that:

- notwithstanding the assertions in the consultation document that "*prudential and conduct of business regulation require different approaches and cultures*" not suited to be housed in a single regulator, recent experience has lead both the regulator and the regulated to acknowledge that "*prudential*" and "*conduct*" labels do not often denote distinct regulatory jurisdictions, but rather different aspects of the same territory (for example, the quality of a firm's management or its systems and controls). Any partition of FSMA, the RAO and the FSA's Handbook will need to take this into account and will, accordingly, be extremely complex – with inevitable implementation difficulties for regulators and firms.
- given the above-quoted major premise as to the necessity to separate conduct from prudential regulation, it is a surprising proposal that the CPMA will become a prudential and conduct regulator of the majority of firms. It will seemingly be both in fact (and, we understand, law) a continuation of the FSA but with a truncated constituency.
- the necessity of establishing collegiate arrangements for major institutions effectively re-establishes a 'shadow' single regulator for such institutions – but without the benefit of a properly unified regulatory organisation and with all the complexities and burdens, for the regulated constituency, of dealing with two formally separate regulators (as to which see the more particular comments below).

2. Statutory objectives (Questions 4 and 10)

We think the case for the removal (for both the PRA and CPMA) of the innovation and competitiveness objectives presently provided for in FSMA may be overstated. There are distinctions to be drawn between:

- the desire for the UK to be "*excessively*" competitive (in practice meaning a place of light touch regulation) and the desire for the UK to be competitive in the sense of having clean, efficient and well-regulated markets, attractive to high quality firms.
- innovation consisting in the manufacture and distribution of new, well-researched and prudently marketed products and services responding to customers' needs and the blinkered, commission-driven manufacture and misselling of poorly-understood products to customers for whom the products are unsuitable.

In both cases the former types of competitiveness and innovation are worthwhile objectives and should be retained, even if there is a desire perhaps to recast them in a more focused form.

3. Rule-making powers and accountability (Questions 4, 6, 7 and 9)

It is stated (at paragraph 3.20 of the consultation) that the PRA is to have:

"*the core regulatory function of making the rules which govern the performance of regulated activities by financial firms [i.e. those subject to prudential supervision by the PRA]*", and it is stated (at paragraph 4.8) that the CPMA is to have:

"the core regulatory function of making the rules which govern the conduct of [all] financial firms, in both retail and wholesale sphere"

Taking up the major theme of this submission - it is at present unclear what distinction is intended between the concept of "*performance*" (of regulated activities) and "*conduct*" and this raises the further question of where the respective future draftsmen of the new rulebooks will start, if indeed they start separately?

- Again the ambiguity of the proposal indicates the implicit concession (which, for the reasons stated above, we consider must be made) that "*conduct*" and "*performance*" (if the latter means prudential aspects of carrying on business) cannot readily be separated in many key areas.
- We suggest that it will therefore be necessary, and beneficial, to encourage or require a collegiate approach to much of the rule-book(s). Again, a shadow single regulator thus would begin to emerge.

It is not clear from the consultation document (in particular see paragraph 3.22 and Question 7) whether the Government is inclined towards making the PRA less accountable for its rule-making than the FSA is at present. Certainly, the discussion is at best neutral, whereas it is apparently settled that the CPMA will continue to be accountable in the same manner.

- We strongly urge that (except in carefully circumscribed circumstances, such as a rapidly developing crisis), the PRA is subject to consultative and cost-benefit analysis disciplines. We do not consider it to be a reflection on the wisdom and abilities of any regulator (or indeed legislator) to say that most proposals are improved by the consultation process.
- Consultation is an essential process for ensuring that regulation develops in a coherent and practicable manner, and avoids unintended consequences (including adverse effects on competition and innovation).

4. Authorisation, approval and passporting processes (Question 5)

The authorisation, approval and passporting processes have in particular potential to cause firms confusion and unnecessary burdens of duplicate regulation.

- If both the PRA and the CPMA are to be responsible for granting permissions (and therefore authorised status) in their respective jurisdictions, multi-service PRA firms will have to undertake two sets of applications and manage two parallel processes, both for the firms themselves and for individuals (some of whom will need to be approved for different roles by different regulators). This, for the firms affected, will be a substantially detrimental step back to the pre-FSMA fragmented supervisory regime. Such inefficiencies, in fact, were among the key drivers for abandoning that system of supervision in favour of a single unified regulatory authority.
- If on the other hand one regulator (presumably the PRA) was made responsible for all authorisation and approval decisions (as queried in Question 5), it would also presumably follow that it should then become the prudential regulator for all firms on the basis that it could not be consistent with principles of good regulation for the PRA to make such decisions in respect of a firm or individual for which it would not then be required to assume a prudential supervisory role. This would leave the CPMA very much as the junior partner of the two authorities, and substantially weaken its position as a conduct regulator. Withdrawal of authorisation (or approval, in the case of individuals) is a potent weapon for a conduct regulator.
- For this reason, there is also now a real risk that the CPMA's effectiveness as a standalone conduct regulator of the largest financial institutions (most of which will be PRA-supervised firms) will be compromised from the outset: in practice the limited ability to impose fines on institutions

which are typically not much inconvenienced by such financial measures (at least without enforcement cooperation from the PRA) will not be regarded as an adequately potent weapon with which to control errant conduct behaviour.

- A collegiate approach – a joint application and approval committee of the PRA and CPMA – may be the most efficient means of dealing with applications from firms subject to both PRA and CPMA supervision. We would then question whether a logical extension of that principle would be to create a standing joint committee to consider all applications across the jurisdiction of both the PRA and CPMA. This could have the benefit of ensuring that standards are applied consistently between the two authorities. It may also facilitate a form of domestic 'passporting' of approvals between the two authorities for cases where, e.g., an advisor/arranger firm which is subject only to CPMA supervision seeks to become a broker-dealer firm with permission to deal as principal.

5. Enforcement, including market abuse

The proposed division of responsibilities will lead to two enforcement regimes for breaches of requirements imposed by the PRA and the CPMA, a market abuse regime administered by the CPMA and, potentially, a separate criminal enforcement regime administered by a new Economic Crime Agency. We are concerned that any such fragmentation of enforcement domains could substantially weaken the credible deterrence initiative championed by the FSA and that the UK's reputation as a robust financial centre in which to do business could suffer as a consequence.

- The consultation document does not address in any detail the matter of overlap: "*It may also be necessary in some circumstances, for enforcement action to be co-ordinated...*" We suggest that these circumstances will in practice be "many", and the most obvious example is perhaps where conduct problems arise from systems and controls failings or the weakness of management.
- It is unclear what "co-ordinated" enforcement action is intended to mean in such a case:
    - Two sets of processes, legally separate (perhaps reaching different findings or part and integration)?
    - Or a unified procedure?
- If a unified procedure is an option, many further questions are raised: could either authority decide to engage the procedure, and which authority would lead? what would happen if in the course of a unified investigation it became apparent that the subject matter raises issues falling within the formal jurisdiction of only one of the authorities? and, most importantly, what would be the legal basis for such a procedure?
- None of these models are attractive from a legal perspective, and they each give rise to potential complexity and uncertainty for regulated firms. Equally, the burden for firms of potentially having to deal with dual enforcement processes could be significant, and the scope for confusion and overlap between investigating authorities must be substantial.
- Moreover there is the potential for conflict in the case of systemically important firms between the objective of the CPMA to punish and deter errant market conduct, perhaps through withdrawal or suspension of permissions or approval, and the objective of the PRA to minimise systemic risk, which may include avoiding such significant supervisory interventions.
- The consultation document explains that a consultation on the powers of the ECA will follow, but we note for the time being that the inefficiencies of any fragmentation of civil and criminal market abuse and insider dealing investigatory and disciplinary powers between the CPMA and the ECA can be expected only to extend and aggravate the difficulties mentioned above. We would prefer to see a single enforcement authority retain both civil and criminal enforcement powers in relation

to market misconduct, including in relation to market abuse, insider dealing and market manipulation.

6. Regulation of markets (Question 17 and 18)

We note that the Government is considering whether to merge the UKLA function of the FSA with the Financial Reporting Council ("**FRC**") to consolidated companies and reporting regulation into one place. We suggest that responsibility for the regulation of markets should be concentrated within the CPMA.

- While we acknowledge the apparent logic of the proposal to establish a powerful companies regulator, we are concerned that any perceived benefit of such a consolidation will be offset by the potentially negative outcome of separating responsibility for and oversight of primary market activity (which should fall squarely within the domain of the CPMA) from that for secondary market activity. The consultation document itself acknowledges the "*synergies that exist between the UKLA and other market functions*".
- A good reason for keeping the UKLA function within the CPMA is to recognise that the boundary between primary and secondary market activity at the time of issuance is not in all cases a clearly defined boundary, and the ability of the market regulator to provide a joined-up approach to the supervision and policing of primary and secondary markets is therefore of significant practical benefit.
- Moreover, if the UKLA function were to be transferred to the FRC, it would presumably follow that the FRC would need to acquire new enforcement competencies in relation to the primary markets. A further fragmentation of enforcement powers, and resources, cannot in our view be desirable, and risks further threatening the viability of the credible deterrence initiative, and thus damaging the UK's reputation as a leading primary market.
- There has been no suggestion that the UKLA's stewardship of the listing authority's function has been flawed and we therefore urge the Government to reconsider whether a transfer of such functions is necessary, or would be substantially productive, at this stage; our preference would be to avoid any unnecessary structural reorganisation and to ensure that the CPMA can function as a fully-competent regulator of markets.

7. Crisis management (Questions 19 to 21)

It is proposed that the Bank of England (the "**Bank**"), both directly and through the agency of the PRA, will be given enhanced powers to deal with financial crises, including overall responsibility for co-ordinating resolution action when it next becomes necessary.

- It is intended that the FPC will use its macro-prudential toolkit to respond to systemic threats to financial stability, with the objective of avoiding the need for crisis management at the level of individual firms. If these measures are not successful, however, the Special Resolution Regime ("**SRR**") may need to be invoked.
- In addition to its responsibilities for supervising individual firms, the PRA will also be responsible for requiring "management action" from individual firms that run into difficulties (which may, for example, include requiring the firm concerned to issue new equity capital) and ultimately for triggering the SRR for failing institutions.
- The existing Special Resolution Unit within the Bank will have responsibility for contingency planning prior to the SRR being triggered and for coordinating measures subsequently deployed under the SRR.
- While we accept the logic of locating these important crisis management functions in one place we are concerned that the Bank (in its many guises) will assume multiple roles the objectives of which

will not be entirely aligned, and may in fact begin to diverge in the very circumstances in which a coordinated approach has been demonstrated to be critical.

- By way of example, we query whether the PRA may be reluctant to trigger the SRR, and thus implicitly acknowledge a failure of its own micro-prudential supervision of the firm concerned. If the Bank, as lender of last resort, finds itself in the position of prolonging the life of an ailing institution, will it be open to the challenge that it had acted to protect the interests of its subsidiary, the PRA?
- As the consultation document acknowledges, *"[i]t is important to ensure that appropriate safeguards are in place to ensure that conflicts do not arise between the Bank's role as lead resolution authority and the Bank's new responsibilities in relation to the PRA"*.
- A solution proposed in the consultation document is to ensure that contingency planning and resolution operations are managed distinctly from the PRA's prudential supervisory operations and will fall within the remit of the Deputy Governor for Financial Stability and not the Deputy Governor for Prudential Regulation. We are concerned that such measures may not prove effective in extreme conditions and this then begins to undermine the rationale for co-locating the related crisis management functions in one place.

We are also concerned by the suggestion that the existing power of the FSA to modify at its own initiative an individual firm's permission to carry on regulated activities could be expanded, and that the trigger points for the PRA and the SRR might be modified "*to ensure intervention is possible before a breach of threshold conditions*".

- Any movement towards giving greater discretion to the PRA to initiate interventions in the financial sector could potentially have significant consequences for the ability of UK institutions to raise new capital at a time when regulatory authorities are seeking to encourage, and in some cases to require, banks and insurers to do just that.
- It will therefore be critically important to ensure that there is clarity as to the circumstances in which such interventions may take place.

One further change contemplated in the consultation document is to give the new authorities supervisory powers over certain unregulated companies, such as holding companies, in circumstances where a regulated firm is failing.

- If implemented, this would mark a significant extension to the scope of the UK regulatory jurisdiction. The FSA (and its predecessor bodies) has not sought to supervise unregulated companies directly; any attempt to do so could raise difficult questions as to the nature and extent of those new powers, particularly in cases where unregulated holding companies are incorporated outside of the UK.

8. International influence

There are, currently and imminently, a very great number of policy initiatives being undertaken at the EU level. These include far-reaching proposals such as the overhaul of the EU regulatory architecture, new capital adequacy rules and radical reviews of key single market directives (for example, MiFID). All of these proposals can be expected to have a potentially significant impact on UK markets and financial institutions, not to mention the powers of UK regulators. Some proposed measures, such as the AIFM Directive, may have a disproportionate and potentially deleterious effect in the UK.

- We share the concern of many commentators that to undertake radical reform of UK regulation at such a critical time of itself gives rise to a real danger that the UK's voice at the EU table will be subdued and weakened, whatever the final shape of the new, post-FSA, regime.

- We share the further concern that the PRA/CPMA model may be an intrinsically weak vehicle for representing the UK at the new EU institutions, especially the EBA and ESMA, because the division of prudential/conduct responsibilities under the UK proposals will not match the division of responsibilities between those two authorities. The PRA and the CPMA is inevitably therefore at risk of being perceived by European counterparts as lacking authority to contribute to certain aspects of the decision making of, respectively, the EBA and ESMA.
- In our view, the obvious collegiate solution – involving representatives from each of the PRA and CPMA (and perhaps also, for the macro perspective, the Bank of England) – if such multiple representation were possible, will be inferior to having UK regulators with authority and responsibilities which are equivalent to those of the most influential regulators from other Member States.

9. Implementation

Again, we share the concern raised by other commentators that the pre-legislative restructuring process which the FSA and the Bank of England have now embarked upon risks creating further substantial disruption both for the regulator itself and for the firms which it supervises and interacts with on a daily basis. As we note in the previous section, this comes at a time when the FSA's limited resources should be focused on supporting the stabilisation, recovery and growth of the UK financial sector and in representing the UK in European and international regulatory forums.

- While we support the principle that the FSA and the Bank of England should prepare themselves for the forthcoming legislative division of responsibilities (and resulting division of personnel and infrastructure), we are concerned that the FSA must not allow service standards to start to fall as senior resources inevitably need to be focussed internally rather than externally.
- We accept the practicality of the interim 'shadow' arrangements which have been proposed (and, we understand, are now starting to be implemented) to prepare the FSA for its eventually statutory division, but if that process is to avoid disruption to the UK financial markets it is critical that those reorganisation arrangements, and their progress, are transparent. Regular updates from the FSA and the Bank, at a minimum, would seem appropriate.
- At the same time we are concerned that the FSA (in its interim form), and in due course the PRA and the CPMA, must recognise that there will be a significant challenge for regulated firms in understanding and adjusting to the new dual-authority regime and the new supervisory cultures of the successor authorities; these challenges are likely to be particularly acute for those firms which will be supervised by both the PRA and the CPMA. Appropriate allowances will need to be made if the UK financial sector is not to bear unduly the costs and administrative burden of the Government's policy decision.

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

Yours faithfully

pp.

Margaret Chamberlain
Chair, CLLS Regulatory Law Committee

TS3/11799744/1/BMG/BMG

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19 October 2010

VIA E-MAIL

Financial Regulation Strategy
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financial.reform@hmtreasury.gsi.gov.uk

Dear Sirs,

CME Group Inc. ("CME Group") appreciates the opportunity to comment on HM Treasury's (HMT) Consultative Paper on "A new approach to financial regulation: judgment, focus, stability" (the "Consultative Paper").

CME Group is the holding company for four futures exchanges, including the Chicago Mercantile Exchange, Inc ("CME"), the Board of Trade of the City of Chicago, Inc. ("CBOT"), the New York Mercantile Exchange, Inc. ("NYMEX") and the Commodity Exchange, Inc. ("COMEX"). CME Clearing, a division of CME, is a central counterparty that provides clearing and settlement services for exchange traded contracts and over-the-counter ("OTC") derivatives transactions that are not traded on an exchange. Our principal regulator in the United States is the Commodity Futures Trading Commission ("CFTC").

In the United Kingdom, CME, CBOT and NYMEX are Recognised Overseas Investment Exchanges, and CME Clearing is a Recognised Overseas Clearing House, the recognitions having been granted by the Financial Services Authority (the "FSA"). In addition, CME Group has a wholly-owned subsidiary, CME Clearing Europe Limited ("CMECE"), whose application to operate as a Recognised Clearing House is nearing the end of the assessment process at the FSA.

CME Group's response to the Consultative Paper is focussed predominantly on the questions posed in Part 5 of the Consultative Paper (question 15) on the proposed division of responsibilities for markets and infrastructure regulation.

The Consultative Paper states that the Consumer Protection and Markets Authority ("CPMA") will regulate the "wholesale markets, including the conduct of all financial services firms in wholesale markets, firms providing market services (such as investment exchanges and providers of multilateral trading facilities) and market conduct generally." Whereas the regulation and supervision of central counterparty clearing houses ("CCPs") will be transferred to the Bank of England.

CME Group believes that under these proposals, there is a major risk that instead of focus and stability in the regulation of financial services and markets, the proposed regulatory split will constitute an unwieldy compromise which unnecessarily complicates the regulatory framework whilst offering no additional clarity or systemic protection.

CME Group believes that it would be more appropriate for CCPs and exchanges to be regulated by a single regulator. This would ensure consistency of regulation and practice, reduce cost and create a strong body which has the expertise and resource to adequately represent both CCPs and market infrastructure firms (such as exchanges) in the UK and at the international level. This should either be the Bank of England (through a wholly owned subsidiary) or a new market regulator with its own statutory objective and its own voice.

Executive Summary

CME Group has the following main concerns in relation to the Consultative Paper:

- The independence and effectiveness of the Markets Division will be compromised by the CPMA's overriding consumer focus and that the interests of exchanges will not be represented adequately – particularly derivatives exchanges;
- The CPMA's statutory objective and style of regulation may not be adequately aligned with the role and objective of the Markets Division;
- There should be a distinction between the regulatory regime for exchanges and multilateral trading facilities, which adequately reflects the key differences in the services offered by both;
- The Bank of England may not represent the interests of CCPs adequately given its likely focus on the banking sector. Provision should be made for a standalone regulatory authority dedicated to CCPs and market infrastructure firms;
- The split between regulatory oversight of two parts of CME Group's business would potentially create serious internal consistency issues;
- If CCPs are to be regulated by the European Securities and Markets Authority (ESMA) at European level, it is unclear how or why the CPMA will be the lead authority representing the UK interests in ESMA given that it will possess neither the responsibility nor the expertise for the regulation of CCPs in the UK.

Regulation of Exchanges

The Consultative Paper states that exchanges will be regulated by the CPMA. Part 4.3 of the Consultative Paper states that the CPMA will be "a strong consumer champion in pursuit of a single objective". As it stands, it is unclear how the CPMA will balance its consumer focus with its responsibility to promote the interests of wholesale markets. It is essential that the expertise and the focus of the FSA's Markets Division should not be diluted in the transference of elements of its responsibility to the CPMA.

Whilst the proposed Markets Division is designed to be operationally independent within the CPMA, CME Group is concerned that the Markets Division will not be able to establish its own identity within such a consumer-focused organisation. Without such an identity, the Markets Division will struggle to command the confidence of the wholesale market sector. Unless the Markets Division is adequately resourced and able to ensure that it possesses the freedom to fulfil its responsibilities its effectiveness and impartiality will be called into question.

In its current form, the primary objective of the CPMA remains too retail focussed. Whilst the primary objective of the CPMA takes account of the need to ensure market integrity, CME Group does not consider this to take adequate account of the need to protect the interests of exchanges in addition to those of consumers. In particular, it fails to adequately take account of the unique interests of derivatives exchanges which are less accessible to consumers. It must have regard to the distinct needs of the wholesale industry and markets in addition to those of consumers.

As an exchange which operates predominantly in the derivative sphere, the risk profile of CME's business is vastly different to that of securities exchanges. Derivatives are complex financial products which are not aimed at the retail market. They are not used by regular retailers in the same way and require a more nuanced type of regulatory oversight. It is not clear how the regulation of these exchanges will be accommodated within the CPMA and whether or not the regulatory regime will be equipped to differentiate adequately between the different exchanges.

Multilateral Trading Facilities & Recognised Investment Exchanges

The CPMA will acquire responsibility for the regulation of Multilateral Trading Facilities (MTF) as well as Recognised Investment Exchanges (RIE). CME rejects the suggestion emanating from some quarters that the regulatory regimes for MTFs and RIEs should be merged. The MTF and RIE regulatory regimes should be kept separate to emphasise the fact that MTFs do not provide equivalent services and products as RIEs. The risk profile and the associated regulatory requirements of MTFs and RIEs are wholly different. To merge their hitherto separate regulatory regimes would compromise the proper perception that RIEs provide a „golden standard' of service which MTFs cannot replicate.

Regulation of Clearing Houses

The Consultative Paper indicates that the Bank of England would be responsible for the supervision and regulation of CCPs. There is a lack of clarity as to which part of the Bank of England would hold this responsibility. If this responsibility is to sit within the Bank of England itself, CME Group is concerned that given the Bank's likely focus on the banking sector there will not be adequate resource or expertise to effectively represent the interests of CCPs. HMT has recognised that the PRA needs to be incorporated as a distinct subsidiary of the Bank of England. CME Group believes that likewise a single regulator for both CCPs and market infrastructure firms (such as exchanges) should be incorporated as a subsidiary of the Bank of England or as a standalone markets regulator. This would ensure that the regulator had sufficient independence, resource and expertise to effectively supervise these systemically important firms.

CME Group incorporates exchanges and clearing services within a single entity. The regulatory structure proposed by the Consultative Paper would lead such organisations being subject to dual regulation – by both the CPMA and the Bank of

England. Dual regulation can lead to potential duplication in reporting obligations and supervisory visits. It can also lead to overlap in areas where business conduct and prudential regulation are closely interwoven. There would be a significant cost implication of such duplication and a major operational challenge to ensure internal consistency. The split in responsibilities would necessitate a very close relationship and constant communication between the two regulators to ensure consistency and to reduce the burden of individual firms being regulated by two separate bodies. It is CME Group's view that this causes unnecessary additional expense and administrative burden to both the regulators and the firms concerned.

CME Group considers the notion of this regulatory split to be highly unusual given the obvious synergies between exchanges and clearing facilities. In no other country in which CME Group operates it is subject to such a regulatory split, importantly this has not caused any apparent detriment to global or regional financial stability. In the US, CME Group is regulated by the Commodity Futures Trading Commission, a single regulator for both exchanges and CCPs. It is our considered view that HMT's proposals as currently framed will create considerable confusion for those operating wholesale markets. This will have major internal structural repercussions which will make London a less attractive base due to the inconsistency of the UK regulatory approach to that of the rest of the world.

Representation of CCPs in the EU

Whilst HMT proposes that the Bank of England should have regulatory oversight of UK CCPs, at a European level it has been proposed that CCPs should be regulated by ESMA. Given this scenario, it seems perverse for the CPMA to represent the interests of UK CCPs on ESMA given that it has no responsibility for the regulation of CCPs in the UK. Without this responsibility, it is difficult to understand how the CPMA would be equipped to represent the interests of UK CCPs adequately in Europe.

There is also a risk that spreading UK representational responsibilities in Europe will weaken the single regulatory voice required to best represent the interests of the UK.

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

Yours sincerely,

Kathleen M. Cronin
Managing Director, General Counsel and Corporate Secretary
CME Group Inc.

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

Co-operatives UK response

About Co-operatives UK

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

The co-operative economy

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

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

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

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

General comments

6. Co-operatives UK welcomes the opportunity to comment on *A new approach to financial regulation: judgement, focus and stability.* In 2001 the Financial Services Authority took over the registrar function for industrial and provident societies (IPS) from the Registrar of Friendly Societies. In the Coalition Programme the new Government set out a commitment to reform financial regulation in the UK. As we understand it, this in particular involves abolishing the Financial Services Authority and replacing it with a number of new bodies. This naturally leads to a question as to what happens with the IPS registration function.

7. Considering its importance, Co-operatives UK is concerned that the consultation does not mention the role of industrial and provident society registrar. However, Co-operatives UK feels it is of the paramount importance that we can feedback with any concerns on behalf of our members regarding the location of the registrar function for IPSs.

8. An effective and efficient regime for IPS registration is particularly important in the context of the new coalition government's emphasis on the potential for co-operatives and mutuals to deliver public services.

9. Co-operatives UK has had concerns for some time about the level of priority the FSA has given to the registrar function for IPSs and has raised these concerns on behalf of its members and the movement generally on a number of occasions since the FSA took over the role.

10. As outlined above, the consultation does not mention the role of industrial and provident society registrar. Accordingly, whichever body takes over the function also needs to be aware of the requirements of the sector in this regard.

11. It is important that the path to registration should be as efficient and easy as it is for other corporate forms, particularly companies. Likewise, the registrar’s role in providing information on societies should be on the same basis as for other such bodies i.e. accessible and searchable online.

12. There is one difference, however, which puts the registration function apart from the simple processing of paperwork. The registrar is duty bound by the legislation to ensure societies registering under the Industrial and Provident Societies Act 1965 are doing so in accordance with the Act, in that they are either a bona fide co-operative or a society that is conducted for the benefit of the community. The registrar does this by examining the rules of each society upon registration and when any subsequent amendments are made. This distinction is fundamentally important to protect the integrity of the co-operative movement.

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

14. However, the registration of companies is focused on process rather than content, operating on the principle of self declaration, in which the onus is on the applicant to ensure that a Company’s governing document is in accordance with the law. It is therefore entirely possible to register a company with a governing document that does not meet the requirements of the Companies Act 2006 or even make sense. The registration process is, however, efficient and inexpensive.

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

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

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

18. As mentioned, we are concerned that the consultation has not considered the role of industrial and provident society registrar. Transferring the function from the Registrar of Friendly Societies to the Financial Services Authority required a legislative change. It is likely, therefore, that a transfer outside the remit of the FSA in its new form will require further legislation, which will not necessarily be a priority for the new government. A simple option for the government is to keep the role within the FSA, albeit under one of its new roles. This aspect concerning any changes to the location of the registrar and, additionally, how any potential changes could be implemented, is a serious omission from the consultation

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

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Complaints Commissioner

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Financial Regulation Strategy
HM Treasury
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SW1A 2HQ

23 September 2010

Dear Sirs,

I enclose with this letter my response to the Consultation document entitled "A New Approach to Financial Regulation".

I enclose a copy of my current annual report. I also enclose a diagram of what, I think, is now being proposed. I hope that I have interpreted the consultation proposals correctly and that it is of some assistance.

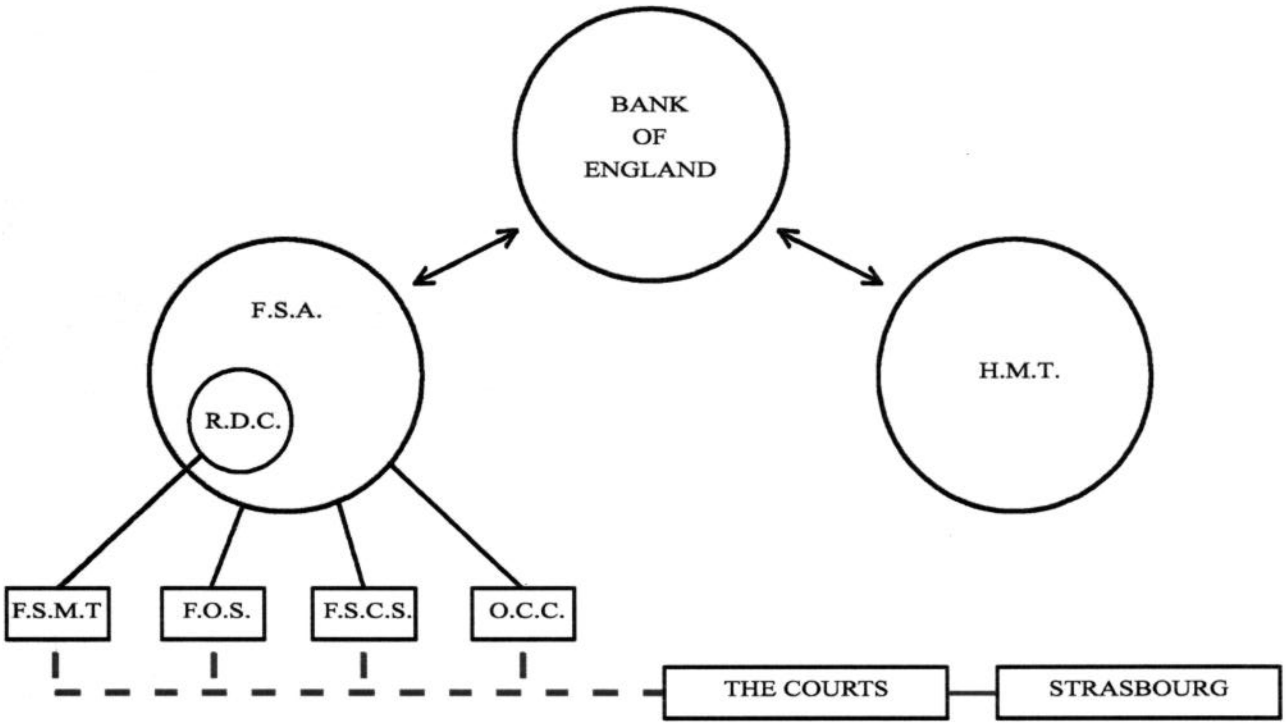
Yours faithfully,

Anthony Holland

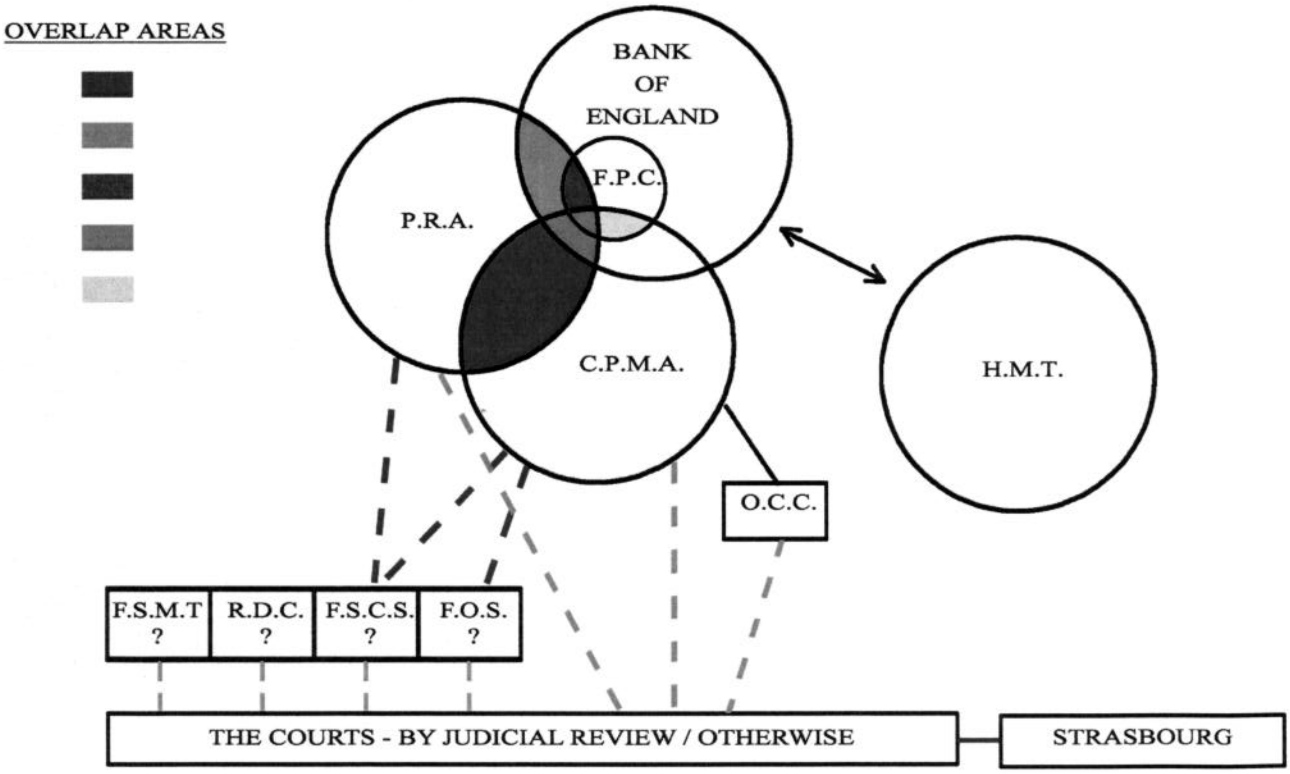
Sir Anthony Holland
Complaints Commissioner

Enc.

Current Arrangements



Proposals



A NEW APPROACH TO

FINANCIAL REGULATION

A RESPONSE BY THE OFFICE OF THE COMPLAINTS COMMISSIONER ESTABLISED BY VIRTUE OF SCHEDULE 1 OF PARAGRAPH 7 OF THE FINANCIAL SERVICES AND MARKETS ACT 2000

Sir Anthony Holland LL.B., M.Phil.,
The Complaints Commissioner
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Contents

1. Executive Summary

1.1 This paper is the Office of the Complaints Commissioner's response to H.M. Treasury's Consultation Paper entitled "A new approach to financial regulation". Due to the specific role of the Complaints Commissioner this paper will focus on:

- The current accountability and oversight of the Financial Services Authority (FSA).
- The current remedies open to the Complaints Commissioner.
- Identifying the sections of the new approach that are relevant purely to the activities of any Complaints Commissioner.
- The overlap in the roles and the interaction between the proposed regulators of the financial services industry.
- The issue of accountability that the two proposed regulators will have in relation to the quasi-legislative functions.
- The aims of the current complaints scheme and the difficult and complex issue of compensation.

1.2 The current Complaints Commissioner took up his role on 4th September 2004 and, after being reappointed in 2007 for a further period of three years, has been reappointed for a final period of three years so that his period of office will expire on 3rd September 2013. All these appointments were subject to the approval of H.M. Treasury. In this response, the Commissioner has adopted the approach of identifying how the current system deals independently with complaints from either the Industry or consumers about the performance of the FSA, the way it has operated and where the pinch points are within the current system. That, on the assumption that under paragraph 4.36 of the Consultation Paper the proposed Consumer Protection and Markets Authority (CPMA) will be subject to a similar mechanism as that required of the FSA.

1.3 It is suggested that Prudential Regulatory Authority (PRA) should also have a duty to maintain a complaints mechanism similar to that required of the FSA including the role of an independent Complaints Commissioner. The Complaints Commissioner currently investigates a number of complaints against the FSA which encompass a broad range of issues, falling mainly in the following categories:

- Mistakes and lack of care on the part of the regulator
- Unreasonable delay
- Unprofessional behaviour
- Bias; and
- Lack of integrity

If the two new regulators are formed, it would be crucial for the purpose of transparency and accountability as proposed in the Consultation Paper that the same mechanism exists for reviewing complaints in the categories above in both the proposed regulators. It would be prudent for the PRA to have its own internal complaints scheme, and for any Complaints Commissioner to remain the independent reviewer for both the PRA and CPMA.

1.4 One Independent Complaints Commissioner for both regulators would ensure that consistency, continuity and transparency is applied across the board. This structure would also be the most cost effective option (given the alternative of having two Commissioners), as well as being the most equitable (given the alternative of a Complaints Commissioner existing only for CPMA).

1.5 It would be prudent if the forthcoming legislation was also to address with clarity the issue of "compensatory payment on an *ex gratia* basis" currently allowed as a remedy to a well founded complaint under the current arrangements. In the past 9 years, since the appointment of the first Complaints Commissioner, this issue has remained open to different interpretations with regard to the actual monetary amount a complainant might receive from the regulator.

1.6 A copy of the most recent Annual Report from the Office of the Complaints Commissioner (OCC) is attached and copies of all previous reports are available on request.

2. Current position regarding accountability

2.1 Under the Paragraph 7(1) of Schedule 1 of the Financial Services and Markets Act (2000) (FSMA), the FSA must make arrangements for the investigation of complaints arising in connection with the exercise of, or failure to exercise, any of (the FSA's) functions (other than its legislative functions) made by eligible complainants. The rules of the complaints scheme are set out in the document entitled Complaints against the Financial Services Authority (also known as COAF). Specifically, paragraph 1.4.1 of COAF provides:

COAF 1.4 Coverage and scope of the scheme

(1) allegations of misconduct by the *FSA* arising from the way in which it has carried out or failed to carry out its functions. The *complaints scheme* covers complaints about the way in which the *FSA* has acted or omitted to act, including complaints alleging:

(a) mistakes and lack of care;

(b) unreasonable delay;

(c) unprofessional behaviour;

(d) bias; and

(e) lack of integrity.

(2) [deleted]

(3) To be eligible to make a complaint under the *complaints scheme*, a *person* (see COAF 1.2.1 G) must be seeking a remedy (which for this purpose may include an apology, see COAF 1.5.5 G) in respect of some inconvenience, distress or loss which the *person* has suffered as a result of being directly affected by the *FSA's* actions or inaction.

2.2 The FSA must appoint a Complaints Commissioner, subject to the approval of H.M. Treasury, in order to carry out the functions imposed by the Complaints Scheme.

2.3 The FSA is, by the scheme implemented under Paragraph 7 of Schedule 1 of FSMA, subject to independent accountability and oversight by a Complaints Commissioner.

2.4 Currently, the Complaints Commissioner operates through a company limited by guarantee, entitled Office of the Complaints Commissioner (OCC). The post of Complaints Commissioner needs to establish a continuing identity, which is separate from that of the individual who is acting in the post, ie a "legal wrapper". This is particularly important in terms of the continuity of the role and for any individual who succeeds the current Complaints Commissioner if his role is continued. The continuity of the role should be established through the ongoing ownership of the contracts and liabilities of the Complaints Commissioner, although at the start under any different scheme there may be none. If any contracts or liabilities are subsequently assumed or established as being the Complaints Commissioner's then the Complaints Commissioner on leaving the post, would have to novate any such contracts which pertain to the post to a successor. Presumably any contracts which could not be novated would remain a legal liability of the outgoing Complaints Commissioner unless otherwise terminated. Furthermore, the ownership of the intellectual property of the post (the complainant files and database) would remain with the Complaints Commissioner in his own personal capacity. That would be undesirable.

2.5 What are the possible outcomes?

2.5.1 If the FSA concludes that a complaint is well founded, it will tell the complainant what it proposes to do to remedy the matters complained of.

2.5.2 Remedying a well founded complaint may include offering the complainant an apology, taking steps to rectify an error or, if appropriate, the offer of a compensatory payment on an *ex gratia* basis. If the FSA decides not to uphold a complaint, it will give its reasons for doing so to the complainant, and will inform the complainant of his right to ask the Complaints Commissioner to review the FSA's decision.

2.5.3 Complainants who are dissatisfied with the outcome of an investigation, or who are dissatisfied with the FSA's progress in investigating a complaint, may refer the matter to the Complaints Commissioner, who will consider whether or not to carry out his own investigation.

2.6 Time limit for the referral of a matter to the Complaints Commissioner

2.6.1 When the FSA writes to a complainant with its final report of its investigation (usually referred to as a Stage One Investigation), or explains that it will not investigate a complaint under the complaints scheme, the FSA will inform the complainant that, if he is dissatisfied, he must refer the FSA's decision to the Complaints Commissioner within three months of the date of that letter.

2.6.2 If the Complaints Commissioner receives a referral of a matter outside the three months time limit it will be for the Complaints Commissioner to decide whether there is a good reason why the matter should be considered out of time.

2.6.3 The Complaints Commissioner's investigation is usually referred as a Stage 2 Investigation.

2.7 The current complaints scheme is widely considered to have worked well. It was set up in order to give the Industry a feeling that its interests, in the context of safeguarding those interests, would not be trampled on by an over-zealous FSA bearing in mind that any regulator must always have due regard to its statutory responsibilities.

2.8 It is recognised that the Industry has expressed concerns about the *modus operandi* of the Financial Ombudsman Scheme (FOS) and to a lesser extent the Financial Services Compensation Scheme (FSCS) but these concerns and these bodies do not come within the jurisdiction of the Complaints Commissioner. That jurisdiction relates only to the FSA and how it discharges its statutory functions both as to the Industry and to consumers.

2.9 Consumers also have access to the jurisdiction but to a less successful extent when compared to the Industry. This is because any dispute will generally revolve around a particular advisor or product as opposed to the FSA exercising its statutory responsibilities.

2.10 Where therefore does the shoe currently pinch?

2.10.1 The most common outcome of a complaint currently relates to the issue of plea discussions in the context of the Enforcement Department of the FSA. The Enforcement Department of the FSA is the department responsible for investigations of misconduct and prosecuting the result of the investigation if that is merited. Sanctions are determined by a quasi judicial process carried out by the Regulatory Decisions Committee (RDC) with a right of appeal to the Financial Services and Markets Tribunal. On many occasions an alleged offender will enter into a discussion to see if he can "strike a deal" as to his sanction without going through the RDC process. Misunderstandings can, and do, then arise.

2.10.2 To prevent this the Commissioner continues to recommend that any such discussions should not be conducted under a hectoring or threatening note but remain cognisant of the importance of the principle of equality of arms to ensure that the lack of representation of the alleged offender is not ignored to his detriment. The best way of achieving certainty in that area and to avoid challenges thereafter is to make a detailed note of the discussion and that that note is agreed by both parties.

2.10.3 The issue of compensatory payments is addressed later in this response (Section 6.)

2.10.4 Other areas that arise relate to fees and their calculation and to authorisations but these issues do not merit individual comment in this response bearing in mind it is accompanied by the Commissioner's annual report for 2009/10.

3. What are the relevant proposals in the context of the current position of the Complaints Commissioner?

3.1 Paragraph 3.38 of the Consultation Paper states:

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

3.2 Paragraph 4.36 of the Consultation Paper states:

The **Consumer Protection and Markets Authority** (CPMA) will be subject to the following accountability mechanisms set out in statute:

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

3.3 The fourth bullet point that is highlighted above is the relevant one in the overall context of this response.

4. The Proposals Under Consultation

4.1 The roles of the regulators and the issue of accountability and oversight

4.2 Although the Consultation Paper contains considerable information on how it is envisaged the proposed financial services regulators will operate, their roles can be summarised as follows:

4.3 The Prudential Regulatory Authority (PRA).

4.3.1 The PRA has been given the role of promoting a stable and prudent conduct of the financial service industry. It will also be given operational responsibility for the regulation and supervision of firms and will take over responsibility for regulatory decision making including the authorisation, supervision and the enforcement of its rules upon firms and take the lead in imposing sanctions (taking action) against firms. From this it appears that the PRA will inherit the FSA's regulation and supervision roles. (In that context therefore the issues raised in paragraph 2.11 above are relevant).

4.3.2 It is noted that the PRA will move from "a tick box approach" to regulation to a "judgement led" approach. Adopting this type of approach, whilst to be encouraged, requires different skills and improved documentation of the rationale for decisions. The Complaints Commissioner on occasions has commented that the FSA does not maintain adequate records and should improve its record keeping. This is referred to in his annual reports. The question therefore arises whether the staff, which will no doubt transfer from the FSA to PRA to undertake these roles, will have the necessary skills to adapt to this new, quite different, style of regulation. Failing to maintain adequate records, and not explaining the rationale behind decisions will leave the PRA open to claims of bias, lack of integrity or negligence. It is therefore important that the decisions made by the PRA staff are subject to review and oversight by an independent body and where complaints are made, particularly by the Industry, an independent review can be conducted.

4.3.3 Although the FSA has, and presumably the new regulators will have, a statutory immunity from claims for negligence with the possibility of an award of damages by a Court, complaints of this nature can be considered under the rules of a complaints scheme. Should this approach be adopted for the PRA (and the CPMA) then, in the event that there are failures in record keeping and a detailed note of the consequent rationale for a decision is not given (or recorded) then it is likely that a considerable number of complaints will be made against the PRA.

4.3.4 Criticism has been made of the FSA by both the Industry and consumers, but not always justified, that the FSA is an entity which operates as it sees fit and is not accountable to anyone. Whilst much of the criticism relates to the failures of the Tripartite arrangement which led to the events of 2008/09, it is important that the PRA, as the lead regulator is seen to be open and to have accountability to both Parliament and an independent body in a similar way to the FSA. It should be easily accessible to both the public and the Industry.

4.3.5 It is essential the PRA assumes and retains the confidence of the public in carrying out its role and duties. The best way of achieving what is being consulted about, and identified in Box 3.E of the consultation paper from the perspective of the Complaints Commissioner is to ensure that where complaints arise about the PRA, there is provided in the legislation a mechanism for addressing them.

4.3.6 This it appears to the Complaints Commissioner is even more important where, as will be the case, there is an overlap of functions carried out by the proposed regulators and those responsible for the direction and input in respect of the proposed regulators.

4.3.7 Accountability can always be achieved through access to the Courts but that is time consuming and expensive and not always a viable option. For all the reasoning applied in this section it seems that a wise course is to provide for a complaints system similar to that which the FSA is currently subject.

4.4 Consumer Protection and Markets Authority (CPMA).

4.4.1 The CPMA has been given the role of promoting confidence in the financial services industry and financial markets. It is envisaged that it will achieve this by undertaking arms length oversight of the operation of firms and markets conducting financial services.

4.4.2 The Consultation Paper indicates that the PRA will be the lead regulator and will have overall responsibility for the supervision of the industry. However, it goes on to say that the CPMA will have responsibility for ensuring that authorised firms comply with its Conduct of Business (COB) rules. Currently the COB rules form part of the FSA's handbook and are monitored, amongst other things, by a firm's Supervision Team. It is unclear how the PRA will be able to fulfil its role and supervise the Industry without considering the COB rules and/or the firms conduct. Having the PRA and the CMPA effectively both supervising a firm is introducing an 'overlap' situation which could cause confusion as well as imposing further regulatory burden on the Industry which is something which the proposals were hoping to avoid.

4.4.3 Having two regulators effectively conducting, to some extent, functions which overlap in some areas, introduces the possibility of inconsistent interpretation of the rules and/or requirements, particularly where judgement based regulation is being implemented. It also again raises the question of accountability and inappropriate comments or instructions on requirements during supervisory visits. This in turn leads to the necessity of the requirement of accountability (through a complaints process) on both bodies.

4.4.4 It is clear that the Government intends to have a degree of independent oversight of both the PRA and the CPMA. However, whilst the Government is consulting on this it is unclear whether it intends to adopt the same procedures for both bodies. This point is raised as, from the above, it does appear that there will be a considerable 'overlap' between the roles of both the PRA and the CPMA even though the PRA will be regarded as the lead regulator.

4.4.5 Whilst both regulators will have different functions, they will also have to work together. In these situations, it is likely that there will be delays and/or mistakes. Where this is the case it is inappropriate for an affected party to be unable to pursue a complaint if the regulator whose actions caused a delaying or a mistake is not subject to the same level of accountability and/or oversight. Transparent lines of accountability therefore need to be in place. Adopting a different level of accountability and oversight would allow a culture of blame passing and a 'muddying of the waters' and possibly prevent the correct resolution of disputes for affected parties.

4.4.6 Although reference is made to the operation of accountability and oversight in a similar manner to that which is currently in operation, it is unclear from the paper whether the Government intends to operate the same arrangements (as set out in Schedule 1 of FSMA which includes a complaints scheme) for both the PRA and the CMPA or whether this arrangement is only intended to be implemented for the CPMA. In so far as Box 4.B needs a specific answer the Complaints Commissioner endorses the proposal contained in 4.36 of the consultation paper.

4.4.7 There needs to be a clear demarcation of the boundaries between the roles and operational process adopted by the CPMA and PRA. From the Consultation Paper, it does not appear, or there is at the very least a lack of clarity, that there is a clear line of demarcation between the proposed regulators. This is particularly relevant if mistakes are made by one or both of the regulators when considering the actions of a firm.

4.4.8 Paragraph 4.51 of the Consultation Paper states:

The new CPMA will continue to have concurrent consumer protection powers where another body is the lead enforcer of a general piece of consumer protection legislation that also applies to financial services. For example, the (Office of Fair Trading) is the lead enforcer in respect of the Unfair Terms in Consumer Contract Regulations (UTCCR) but the FSA currently has a role in enforcing rules about unfair terms in consumer contracts in financial services. The Government envisages that the CPMA will assume all the FSA's existing functions in this respect to ensure that it can credibly carry out its role as a consumer champion and take action where it considers a contractual term to be unfair.

4.4.9 There is a distinct lack of clarity in that proposal since it makes the assumption that the issue of contractually unfair terms will in the future rest entirely within the purview of the new CPMA and that in turn could involve the jurisdiction of any successor body to the Complaints Commissioner as promised in 3.38 of the consultation paper.

4.4.10 What liability the CPMA will have to consumers in this area is for Parliament to decide and whether that would include, as it is hoped, individual consumer cases coming within the jurisdiction of any successor body to the Financial Ombudsman Service (FOS). In the particular context of this issue however, consumers might find themselves outwith the jurisdiction of any FOS but still maintain, to any Complaints Commissioner, that the CPMA has failed in its duty to protect consumers by allowing to subsist an unfair term in, for example, a contract of insurance against legal expenses. This in turn could lead to an issue of what compensation should be payable and how should it be calculated if on an *ex gratia* basis.

4.4.11 The Complaints Commissioner does not have the jurisdiction currently to entertain complaints about a particular product provider and a consumer of that product. That jurisdiction is fulfilled by the existence of the FOS and should be replicated at the end of the current process of change.

4.4.12 The issue of clarity in this area is important and it is essential that there exists a clear dividing line between the jurisdiction of any Complaints Commissioner and any new or enlarged FOS. The Complaints Commissioner must not become a second port of call for a consumer who fails at the hands of the FOS.

5. Additional comments on the proposed arrangements

5.1 The proposals raise a number of other questions. Currently the FSA, as the sole regulator, has overall responsibility for the regulation of the Industry and the supervision and enforcement of its rules upon the firms operating in the Industry. Under the proposals, there will be two regulators who will each have responsibility for the regulation and supervision of the Industry. Whilst it is accepted that under the current regime there may be an 'underlap' in the regulation of the Industry and that this 'underlap' could have led to the recent financial crisis, is it correct to replace this 'underlap' with an 'overlap'?

5.2 The proposed 'overlap' will impose two sets of rules on the Industry which will increase the 'compliance' burden on regulated firms. It also opens the Industry to the possibility of conflicting requirements set out within the rules within which the PRA and the CPMA expect the Industry to operate. This is even more the case where the regulation is judgement based. Ultimately, having two regulators taking responsibility for authorised firms could lead to the possibility that, where action is needed, there will be confusion over which body is to take action and whether either body is also to take action against a firm or individual. This could have an impact on consumers particularly where there is concern over whether a firm has sufficient permissions (or even authorisation) to conduct a specific type of business, as well as complying with the appropriate rules.

5.3 Adopting, as will be the case, two sets of rules will clearly increase rather than reduce the burden on firms, particularly in relation to compliance costs, record keeping and reporting requirements.

5.4 The key issue as far as any complaints system is concerned is that transparency as well as accountability needs to be clearly demonstrated. If the two new regulators are formed, it would be crucial for the purpose of transparency and accountability as proposed in the Consultation Paper that the same mechanism exists for reviewing complaints in the categories above in both the proposed regulators. It would be prudent for the PRA to have its own internal complaints scheme, and for any Complaints Commissioner to remain the independent reviewer for both the PRA and CPMA.

5.5 One Independent Complaints Commissioner for both regulators would ensure that consistency, continuity and transparency is applied across the board. This would be especially the case where a complaint relates to the actions or inactions of both the PRA and the CPMA in relation to the same issue. This structure would also be the most cost effective option (given the alternative of having two Commissioners), as well as being the most equitable (given the alternative of a Complaints Commissioner existing only for CPMA).

5.6 Whilst the Bank of England is accountable to Parliament (through H.M. Treasury) it is unclear how the PRA and CPMA, exercising a quasi-legislative functions, will be accountable. The Consultation Paper indicates that consideration will be given to subjecting the PRA to the same accountability as that experienced by the FSA. The PRA will be (as the FSA is) responsible for the authorisation, supervision and will be the lead regulator in enforcement action. As such, in line with the current practice for any quasi-legislative body, it should adopt a complaints scheme. The proposals are unclear as to whether that is intended.

5.7 Although the PRA should be subject to a complaints scheme, it would be inappropriate however to consider complaints in relation to the conduct of the PRA when conducting its legislative function, those which amount to simple dissatisfaction about its general policies and those which should be dealt with in another way.

5.8 This is currently the case with the FSA under paragraphs 1.4.2, 1.4.2A and 1.4.3 of COAF which state:

COAF 1.4.2 Exclusions from the scheme

Each of the following is excluded from the *complaints scheme*:

(1) complaints about the *FSA's* relationship with its employees;

(2) complaints connected with contractual or commercial disputes involving the *FSA* and not connected to its functions under the *Act*;

(3) complaints in relation to the performance of the *FSA's* legislative functions under the *Act* (including making *rules* and issuing codes and general *guidance*); and

(4) complaints about the actions, or inactions, of the *Financial Ombudsman Service* or the *Financial Services Compensation Scheme*.

COAF 1.4.2A Circumstances under which the FSA will not investigate

The *FSA* will not investigate a complaint under the *complaints scheme* which it reasonably considers amounts to no more than dissatisfaction with the *FSA's* general policies or with the exercise of, or failure to exercise, a discretion where no unreasonable, unprofessional or other misconduct is alleged.

COAF 1.4.3 Complaints that are more appropriately dealt with in another way

The *FSA* will not investigate a complaint under the *complaints scheme* which it reasonably considers could have been, or would be, more appropriately dealt with in another way (for example by referring the matter to the *Tribunal* or by the institution of other legal proceedings).

5.9 A reduced and simplified rule book is to be encouraged. Where rules are open to interpretation by both the firm and the regulator, concern must be raised, particularly if the regulator is not open to clear and independent accountability and oversight. Here, as indicated in paragraph 4.3.2 above, the rationale for taking the action felt appropriate must be clear and open and seen to be arbitrary as this leads to a situation here the regulator could be regarded, at best, to be inconsistent or at worst acting unprofessionally or negligently. This is a situation which should not be allowed to develop and emphasises the importance of the

PRA and CPMA being subject to independent accountability and oversight through a complaints scheme.

5.10 The Consultation Paper indicates that there is to be considerable interaction between a number of bodies and Industry regulators. Where there is interaction it is important that these interactions are documented and records are kept and are accessible for future review. Failure to do this will lead to claims, whether warranted or not, that the regulators failed to act accordingly or took inappropriate decisions.

6. The issue of Compensation and the meaning of *ex gratia*

6.1 Earlier paragraphs set out the current position on the issues raised by the heading of this section. The current complaints scheme does not give a right to financial awards called damages to successful complainants, and is only under the obligation to offer compensatory payments if a complainant can demonstrate a direct financial loss (which would not have been incurred had it not been for the FSA making a decision which upon review of the information available to it at the time was incorrect) the FSA can then make an award on an *ex gratia* basis. Will that position change as a result of what is now under consideration?

6.2 The last time this matter arose was during the passage through Parliament of the Financial Services and Markets Act 2000. In Appendix A to this response is attached a reproduction of the terms of a debate that then took place without ultimately arriving at a final conclusion. The report in Hansard (27 January 2000) is worthy of consideration at this juncture as the difficulties that were canvassed then remain alive today.

6.3 The Industry funds what is put in place in terms of the overall regulation of the Industry but would no doubt be seriously concerned if that funding could be open ended in terms of compensatory payments and the consequential legal costs if recourse was had to the Courts.

6.4 The current wording within the current scheme has not led to large awards by the Complaints Commissioner for a number of reasons:

6.4.1 the issue of direct causation of loss caused by the FSA is not necessarily easy to establish;

6.4.2 the complainants themselves were often primarily to blame because of the actions that they took;

6.4.3 it is clear that it is the case that other third parties bear some degree of responsibility;

6.4.4 the loss suffered could not have been in the contemplation of the FSA – it is simply too remote;

6.4.5 a sufficient degree of culpability cannot be laid at the door of the FSA;

6.4.6 what is called a *novus actus interveniens* (an intervening act) breaches the chain of causation.

6.5 This list is not exhaustive but gives some indications of the hurdles that have to be surmounted. That is in addition to the fact that the current scheme does not involve hearings or representation at hearings and a consequential forensic examination of the relevant evidence. Quite apart from the fact the current scheme refers specifically to "compensatory payments" and not damages and that the figure awarded is to be *ex gratia*. That is, it is a discretionary award.

6.6 The FSA is well aware of the problems posed by this whole issue and the position that it arrived at after extensive consultation (see CP73 (November 2000) and CP93 (May 2001) seemed to result in a compromise acceptable to all.

6.7 However The Law Commission has also looked at the problem of Administrative Redress between Public Bodies and the Citizen and has issued a Consultation Paper No 187 to which the FSA responded on 30 October 2008.

6.8 The view could be taken when considered objectively that the current position, despite some uncertainties, represents a reasonable compromise having regard to the existence of the FOS, the FSCS and this office that ensures accountability of the Regulator as set out in 2.1 hereof.

6.9 Any complaints scheme which the Government puts in place as a result of the Consultation Papers must address the issue of Compensatory Payments possibly on the same basis and taking account of both the requirements of EU law and the Human Rights Act (which FSMA does).

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APPENDIX A

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Is the hon. Member for Arundel and South Downs (Mr. Flight) pressing the amendment?

Mr. Flight: I thought, Mr. Deputy Speaker, that I had indicated in what I just said that we would not press the amendment to a vote.

Mr. Deputy Speaker: Is the hon. Gentleman therefore withdrawing his amendment?

Mr. Flight: I beg to ask leave to withdraw the amendment.

Amendment, by leave, withdrawn.

Miss Melanie Johnson: I beg to move amendment No. 480, in page 197, line 47, at end insert--

"( ) The complaints scheme must be designed so that, as far as reasonably practicable, complaints are investigated quickly.".

Mr. Deputy Speaker: With this it will be convenient to discuss the following amendments: No. 186, in page 198, line 27, leave out "reference" and insert "submission".

No. 187, in page 198, line 27, leave out--

"which the Authority is investigating".

No. 23, in page 198, line 33, leave out "and".

No. 32, in page 198, line 36, at end insert--

"; and
(iv) to recommend to the Authority the award of such sum as appears to him to be fair and reasonable in all the circumstances of the case in relation to any maladministration by the Authority.".

No. 188, in page 198, line 36, at end insert--

"(iv) to make an award against the Authority of such amounts as he considers fair compensation for loss or damage resulting from the subject matter of the complaint".

No. 189, in page 198, line 37, leave out "Authority" and insert "investigator".

No. 190, in page 198, line 37, leave out--

"it must notify the investigator"

and insert "must notify the complainant".

No. 191, in page 198, line 39, leave out sub-paragraph (4).

Government amendments Nos. 437 to 441.

Miss Johnson: The complaints scheme is an important part of the accountability package delivered by the Bill. The Bill should deliver an open and transparent mechanism that will allow people's complaints to be dealt with quickly, cheaply and informally.

However, the Bill delivers other important protections as well. For example, firms will be able to go to the financial services and markets tribunal to challenge the FSA's decisions. The Government introduced amendments to the complaints scheme provisions following the Joint Committee's recommendations, to make it clear that the investigator should be fully independent of the FSA. That independence will include having adequate funds and staff.

The investigator's appointment is also to be approved by the Treasury, and he or she cannot be removed from office without the Treasury's consent. It is important that

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everyone is happy with the independence of the arrangements, and the FSA will consult further on them fairly shortly. I understand that the issues to be studied are likely to include ways to secure the investigator's independence through the appointment arrangements and the provision of independent support staff. I recognise how important it is to secure the investigator's independence. The Government amendments, together with the provisions already in the Bill, will achieve that.

I shall not respond to the Opposition amendments now, Mr. Deputy Speaker, in the hope that I will have the opportunity to do so later.

Mr. Flight *rose--*

Mr. Deputy Speaker: Order. Perhaps I can help the Minister. By leave of the House, she is able to speak a second time, as she would be were she tabling her own amendment. However, it may be for the convenience of the House were she to say all that she wishes to say on this occasion, in case she wishes to come back a second time later.

Miss Johnson: Thank you for your guidance, Mr. Deputy Speaker. I shall take this opportunity to make some brief remarks about the Opposition amendments in this group.

The amendments would partly take the FSA out of the process--or at least, they would not give it the opportunity to deal with complaints in the first instance. The

Government consider that it would not be sensible to take the FSA out of the process in the way proposed. Most complaints arrangements--such as those relating to regulating firms under the current system--give the subject of the complaint the chance to put his house in order before an independent investigator is brought in. What would be the implications for the time and resources of the investigator if he or she were to investigate all complaints in the first instance? We are trying to set up a mechanism for cases which the FSA cannot resolve with complainants, not a first port of call, and not a port of call for every single case that might arise.

3 pm

The scheme nevertheless ensures transparency, so if the FSA decides not to investigate a complaint, the investigator should know about it; and if the authority decides to go ahead and investigate, again, the investigator should be informed. The investigator can then take up the complaint if he or she sees fit.

Of course, if the FSA does not sort out a complaint satisfactorily, the independent investigator comes in. Taking the FSA out of the picture in the first instance would not be right or efficient.

The Joint Committee suggested that we consider the possibility of ex gratia payments. We have been doing that, and we continue to do so, but it is not appropriate to come to a decision until we see the FSA's consultation paper on the proposed arrangements for the complaints scheme. Amendment No. 188 argues for just such compensation.

It is important that the complaints scheme is not seen as a means of circumventing the FSA's statutory immunity. We do not want to encourage people to take

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pot shots at the FSA and distract it from its proper business of regulating. As the scheme is not part of the Court Service--indeed, the investigator need not be a lawyer--he or she would not necessarily come to a decision based on legal principles that a court would apply. The complaints scheme is an informal mechanism for investigating complaints and, where appropriate, bringing shortcomings into the open; it is not a court, nor is there a right of appeal for the FSA if the investigator makes an adverse finding against it.

Although the Bill does not give the investigator the power to award damages, the complaints scheme will have real teeth. The investigator can publish his or her reports and has the power to name and shame the FSA--or, if he or she sees fit, individuals within it. Therefore, the strength of the arrangements should not be underestimated. The FSA will also need to include details concerning complaints in its annual reports to the Treasury and to Parliament.

I hope that, once they have considered my remarks and the Government amendments, hon. Members may see fit to withdraw their amendments in this group.

Mr. Flight: Government amendment No. 480 is quite acceptable. It responds to an issue that we raised about speeding up the handling of complaints.

We are now in the single most important territory of principle. As the Burns committee set out in its doctrine, and as has been the universal response from the industry, if there is to be effective legal immunity, there must be a clearly independent system of complaints--if not with the ability legally to award compensation, with the ability to recommend and suggest fair recompense when businesses have been damaged by incorrect or wrong conduct by the FSA.

As the Minister has just said, in Committee the Government accepted the principle that the investigator could suggest ex gratia payments. There is no Government amendment to that end, and the Minister has said that the matter is still under consideration, awaiting the FSA's comments. We ourselves have had discussions with the FSA on this issue. It pointed out that, if the payments were compensation, there would be a potential problem of legal disputes, particularly over matters such as the refusal of applications, but it is perfectly happy with the principle of ex gratia payments being recommended to it. Amendment No. 32 has been worded deliberately to accommodate that. It proposes that the investigator recommend suitable sums for payment by the FSA, so that it will ultimately be an ex gratia regime.

We will wish to withdraw amendment No. 188, which is clearly stronger, and sets out a specific proposal for compensation. Our other amendments seek to create a complaints regime that is fully independent. While there may be something in the argument that the complaints investigator's time should not be wasted with minor issues, the bigger argument is that it is inappropriate for all complaints to come to the FSA first. The FSA has the power of life or death over businesses in terms of authorisation. There is considerable fear of the FSA in the industry--fear that, if offence is given or a foot is put out of line, a business may suffer. It is therefore inappropriate that complaints should first be vetted by the FSA. The investigator needs to be fully independent to receive and consider complaints, and recommend recompense if a business has been genuinely damaged by a wrong action by the FSA.

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We shall come in due course to the issue of legal immunity. The two issues might best have been debated together, but it is absolutely clear that, in achieving a fair and sensible balance of power--if there continues to be effective legal immunity, as the Bill at present prescribes--it is essential, as the Burns committee made clear, to have an independent system of complaints, and for the body concerned to be able to recommend, if not award, fair payments for damage suffered by businesses as a result of the FSA's mistakes.

Sir Nicholas Lyell: I agree with the points made by my hon. Friend the Member for Arundel and South Downs (Mr. Flight), including those about the importance of having an independent investigator who can award compensation, of at least a reasonable nature.

My hon. Friend pointed out that our amendments are in two forms--amendment No. 188, which requires that the investigator be able to award compensation, and amendment No. 32, which requires that he or she be able to recommend an award of compensation, leaving the ultimate decision to the authority. To that extent, it would be ex gratia. We put that in to water down our recommendation, to make it easier for the authority, and to stop it being frightened that its immunity would thereby be completely undercut.

We are the Opposition, not the Government. The Government need to reflect seriously and carefully on exactly how to handle this matter. I echo my hon. Friend's statement that the recommendation was made by the Burns committee, which gives it great weight, just as the committee's views on the chairmanship and the question of chairman and chief executive gave that great weight. I hope that both those matters will be reflected on extremely carefully.

This group of amendments and the next group, on immunity, hang together, as my hon. Friend rightly said. The Minister knows that I support a substantial degree of immunity for the FSA. I think that it is necessary, for the reasons that my hon. Friend stated. We do not want to see the authority undercut, and, as the Minister said, we do not want unreasonable pot shots. They may be much more than pot shots; they may be major attacks by extremely powerful institutions.

That is one side of the picture. The other side is that the FSA is being given immense power over the livelihoods of thousands of people whose own money is at risk. If it performs its functions badly, it should be capable of being held to account. If it does significant damage to individuals working in the market through its own fault, there should be some comeback and some financial compensation. The authority is big enough to be able to behave properly to those whom it has a duty to regulate, but whom it has let down as a result of inadvertence, stupidity or worse.

I hope that that will not happen very often, but I would feel much more confident about its being a rare occurrence if I knew that the authority was aware that it must look over its shoulder, at least to a limited extent, and realise that if it messes up those working in the market or others through its own incompetence or error, it can be held reasonably to account for at least reasonable sums to return them to the position in which they ought to have been.

We are setting up a huge institution. What we are doing is unprecedented. We really must be big about it: we must not be frightened--Governments, whatever their

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complexion, must not be frightened--to be prepared to pay compensation to those who suffer when misregulated. There is no reason why the whole regulatory system should collapse as a result of that balance.

If we do not get this right, Strasbourg may eventually force us to get it right. One of the problems of this Bill is that it is so defensive about the idea of judicial review. Nearly every provision that could be drafted so as to inhibit the opportunity for judicial review is thus drafted. It will not prevent judicial review on the part of financial institutions that are rich and powerful enough to afford that expensive and complex process, but judicial review would be far less necessary if the system involving the investigator and reasonable compensation were established properly.

I am in favour of that system. I am in favour of a comparatively formal process. However, if it is so boxed in--if I may use another contentious phrase--that it is not effective, people will look outside it. Eventually, they will take the cases to Strasbourg. They will rely on article 6 of the European convention on human rights in relation to lack of due process, on article 7 in relation to the right not to be punished except in accordance with the law, and on the first protocol of article 1, which relates to the right to possession of property. If someone is running a business that is also his property, and if that business is seriously damaged as a result of the authority's incompetence, possession of the property may be denied him. In one way or another, people will find a way of bringing a case outside the confines of this country.

Let us get the legislation right. Let us ensure that it is reasonable and balanced.

Miss Melanie Johnson: We are still considering the issue of ex gratia payments. The FSA is consulting on it, and I do not think it appropriate to pre-empt the results of its consultation. I am not saying that we will decide one way or the other; I am saying that we are waiting for the results.

I do not think that people should view the complaints investigator as a potential first port of call, as the Opposition seem to suggest. In any event, the post is not being established for the purpose of financial redress; the point is for the focus to be on the process, and on the importance of transparency.

3.15 pm

Mr. Heathcoat-Amory: We have had a short but important debate on some important amendments.

The Opposition consider the investigator's role to be crucial in providing a check on any abuse by the FSA, and any negligence or incompetence on its part. We may have regard for, or even confidence in, the authority's senior management, but that is not always reflected in people's experience of its staff at the coalface, as it were.

Hon. Members receive many complaints about regulators. It is important for complaints to be dealt with promptly by an independent inspector who is seen to be independent, and who can receive them separately from any filter mechanism that may exist in the authority. The inspector must be properly resourced, and able to respond to complaints--including, we believe, complaints involving financial awards against the authority.

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Our proposals would also establish an essential counterbalance against statutory immunity. We shall debate that shortly, so I shall not go into it now, but I want to quote one sentence from the report of the Joint Committee on Financial Services, of which I was a member last year. It concluded, among other things:

"We agree with those who see a robust complaints procedure as the central counterbalance to the FSA's statutory immunity."

It asked the Government to give serious consideration to the issue of financial awards.

I do not think that it is enough simply to refer to the possibility of ex gratia payments that are not mentioned in the Bill. That is not an assurance at all. I know that the Government do not want to allow the FSA to get into a legal tangle in regard to what might be compensation, and that that might have to be judged against some objective criterion. I think we should leave open exactly how awards are to be measured and made, but they must be referred to in the Bill. That is the thrust of the Joint Committee's conclusions, and it is the strong view of the Conservative Members who have spoken. We do not intend to press the other amendments, but we will press amendment No. 32.

Amendment agreed to.

Amendment proposed: No. 32, in page 198, line 36, at end insert--

"; and
(iv) to recommend to the Authority the award of such sum as appears to him to be fair and reasonable in all the circumstances of the case in relation to any maladministration by the Authority.".--*[Mr. Heathcoat-Amory.]*

Question put, That the amendment be made:--

The House divided: Ayes 141, Noes 267.

Response October 2010

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

CBI response to HMT consultation

Jon Hogan | Head of Financial Services | CBI

The CBI supports the government's objective to ensure that changes to the UK regulatory framework increase financial stability. But this objective needs to be balanced with the need to promote economic growth, choice and responsible innovation in financial products, and maintain the UK's competitiveness in financial services.

Introduction

The CBI welcomes the opportunity to input to the Government's proposals for changes to the financial regulatory architecture.

Our comments are designed to ensure that the detail of the proposals work effectively within the parameters of the overall direction of the reforms that the government has indicated. In particular, we want to ensure that the proposals support economic growth and the competitiveness of UK financial services.

We set out below a number of headline concerns where we feel there is scope for improvement, along with some detailed comments on each of the main component parts of the proposed new regulatory system.

The CBI's overall position on financial regulatory reform

The CBI believes that major financial reform is both necessary and underway at international, European and UK level in the wake of the financial crisis. The status quo is not an option. But we need a clear focus on what the reforms are designed to achieve, what mix of proposals will best deliver this objective, and what approaches we favour.

Our priorities for financial reform are to deliver better management of systemic risk, to ensure banks are in a position to finance the economic recovery and to maintain the UK's position as a leading global financial centre.

So the CBI's "three tests" for FS reform, and our assessment of the regulatory architecture proposals against each of these three tests, are:

1) Do they deliver better management of systemic risk, to reduce the economic impact and exposure of the public purse in the event of any future financial failure?

   No regulatory system was proven to be infallible during the financial crisis, and the quality of regulation is the critical issue. But the proposed changes to the regulatory architecture, in particular the new Financial Policy Committee would introduce powerful new macro-economic tools designed to tackle systemic risk.

2) Will they enable financial services firms to play an efficient role in the economy and finance the recovery, supporting businesses and consumers?

It will be important to pursue a balance of objectives between stability and protection on the one hand, and competition and innovation on the other, to ensure that the UK financial services sector can continue to support business, consumers and economic growth in the future.

3) Are they internationally coordinated to be effective and avoid undermining the competitiveness of individual countries, and harming their economies? Given the number of UK financial hubs regarded as globally important, this is particularly relevant to the UK.

The key issues to address in designing the new system from a UK competitiveness test are to ensure that the UK is effectively represented in international debates in the future, where both the transition and UK position at ESMA require careful handling.

Headline concerns to address

(1) Clarity of mission and objectives, with sufficient emphasis on competitiveness

The CBI believes that there needs to be greater clarity over the mission and objectives of the proposed new regulatory architecture.

The starting point should be to set out a clear vision of the financial sector we want in the UK in the future. The CBI believes this would include:

- The provision of a stable and affordable supply of credit, to business and consumers
- A competitive range of financial products and services, characterised by choice and diversity for business and consumers
- A vibrant financial sector, with the UK continuing to be a leading global financial centre

The government sets out the reasons for the financial crisis, including global economic imbalances, mispriced risk, unsustainable funding models, excessive debt, and development of a shadow banking system. It says the UK regulatory framework failed to identify the problems that were building up, take steps to mitigate them and to deal adequately with the crisis when it did break.

Whilst the CBI agrees with this analysis, we believe that the government's proposals are in danger of placing too much emphasis on stability and protection. The broad objectives for the regulatory architecture should also be to promote choice and responsible innovation in financial products, and have regard to the UK's competitiveness in financial services.

For example, we believe there is a risk that the new Financial Policy Committee could become too focused on stability at the expense of economic growth. And similarly, we believe that the Prudential Regulatory Authority should have a more rounded set of objectives.

(2) Concentration of powers, and need for clear governance and accountability

There needs to be clear governance, accountability and commitments to open consultation to allay fears about a concentration of powers in the new approach to financial regulation.

The changes will result in a structure with a very different balance of powers and responsibilities between the new authorities.

There will be a substantial concentration of authority within the Bank of England. As chairman of the Financial Policy Committee, the role of the Governor of the Bank of England will be dramatically enhanced, and it is essential that the governance arrangements of the new bodies enhance overall accountability in the new system.

We also believe that the PRA requires a more robust and transparent policy framework to set out what it can do, the consultation process and appeals mechanism it will work to. The attractiveness of the UK as a place to do business will be damaged if governance of prudential regulation is too uncertain.

(3) Fears around regulatory double-keying and reporting

For financial services groups the proposed structure will mean different parts of their business will have different lines of supervision. So it is important that the different parts of the regulatory architecture have integrated systems to avoid double-keying and reporting to different regulators

For example, for many in the insurance sector prudential supervision for pensions and savings will rest with the Bank of England, whilst their investment management business would be overseen by the CPMA.

This underlines the need for proper co-ordination otherwise no single supervisory body will have an integrated strategic view of the business. There is a danger that the design of the new architecture is designed with the prudential supervision of the largest banks in mind, without sufficient thought to the impact on other industry participants.

(4) Need to balance protection with competition and choice

The CPMA will be given responsibility to regulate the conduct of all financial services firms, and also primary supervisor for all smaller firms, investment managers and hedge funds. Its primary objective will be to ensure confidence in financial services and markets.

As with the PRA, important factors vital for a thriving competitive market place are left to secondary statutory considerations. The CBI believes that the key elements of the regime should be included within primary legislation to ensure appropriate Parliamentary scrutiny.

We are also concerned that an authority that is on the one hand a 'consumer champion' will be in conflict with the relationship needed with firms to be an effective supervisor. Competition acts as an important counterbalance to protection by ensuring a focus on open markets rather than regulatory protection, and we believe should be more explicit in the role envisaged for the CPMA.

(5) Need for the UK to maintain a powerful international and EU influence

Increasingly it is Europe which directs the regulatory environment within which UK firms operate and changes to our architecture must place greater emphasis on putting the UK on the front foot in debates, with the heft (in terms of sufficient staff, resources and thought leadership) both within the UK authorities and within the new European bodies, to lead the direction of discussions, and ensuring that the right outcomes are achieved for a thriving competitive industry.

So it follows that the new UK authorities, where appropriate, be constructed to 'map' their responsibilities to those of the new EU bodies, in order to maximise the UK's influence in rule making and supervisory issues.

(6) Transition issues need careful handling

The transition to the proposed new regulatory architecture needs careful handling, both to avoid a loss of focus during the interim period, and to ensure the UK maintains a powerful influence in EU and international debates.

Whilst the financial sector is out of the emergency ward, it is still in rehabilitation. So we need to guard against further regulatory distractions when the sector is undergoing significant change and requires substantial monitoring.

And second, if we allow changes to our domestic regulatory structure to become a distraction, the UK industry risks losing out as key European financial debates reach their critical stages. Over the coming year new rules and supervisory arrangements will cover significant parts of the industry including hedge funds and private equity, insurance, derivatives trading, transparency and reporting requirements, and corporate governance. And against this backdrop, new supervisory and rule making structures are being built up where it is important the UK has influence.

Specific comments on component parts of the new regulatory architecture

Financial Policy Committee

The CBI believes that it is important that the Financial Policy Committee (FPC) has a balanced set of objectives to support a thriving UK domestic and international financial services industry.

As they currently stand the proposals would give the FPC an unconstrained objective for financial stability and a set of powerful macro-prudential tools to use on UK firms, such as altering risk-weights and setting limits on lending.

We believe it is important that the FPC should also emphasise the need for its actions to be consistent with supporting economic growth, and these broader factors should be set out in formal objectives for the FPC

Given the global nature of the financial system, we believe that international coordination will be needed for any stability actions to be effective this should also be reflected in the FPC's objectives.

Prudential Regulatory Authority

As with the FPC, we believe it is important that the Prudential Regulatory Authority (PRA) is set balanced and rounded objectives. These should include factors such as proper coordination with other financial regulatory bodies, maintaining an appropriate regulatory burden and balancing matters of public interest, all of which should be given proper consideration before actions are taken against firms around stability.

As currently proposed, we believe that the PRA should have more robust and transparent governance arrangements in place. We believe the PRA should have a more robust and transparent policy framework to set out what it can do, as well as greater clarity around the consultation process and appeals mechanism it will work to.

Failure to provide this will lead to uncertainty around rule-making and the regulatory process, making the UK a less attractive place to do business for financial services.

Consumer Protection and Markets Authority

The CBI's chief concern around the proposals for a Consumer Protection and Markets Authority (CPMA) is the implication of an over-emphasis on consumer protection, at the expense of promoting competition and choice.

To address these concerns, we feel it is particularly important that the secondary considerations highlighted in the consultation document are given sufficient weight and emphasis in setting the remit for the CPMA. In particular, we are keen to ensure that the CPMA:

- Does not stifle competition and innovation in financial services at the expense of consumer protection
- Does not have an adverse impact on lending to business and consumers, an issue that will be critical to re-balancing the economy and building sustainable growth
- Continues to promote diversity in financial services, not least because there is a need to be vigilant about this with the increasing use of product regulation over market regulation
- Should be required to adhere to better regulation and consultation requirements expected of government departments and agencies

We also believe that greater clarity is required to spell out how the CPMA can reconcile its roles as a 'consumer champion' and independent regulator whilst also maintaining its relationship with firms as an independent and effective supervisor.

Markets and Infrastructure

The CBI does not support the proposal to merge the UKLA with the FRC, as a first step to creating a companies regulator.

Our starting point is that it is not clear what problem the proposal is seeking to address. There are no obvious synergies between the UKLA, which is a real time markets regulator, and the FRC, which is a standard setting regulator.

Our chief concerns about the proposal are:

- It is critical to ensure that the City retains a powerful voice in Europe at a time of substantial regulatory change and these proposals would, at best, be an unwelcome distraction. The CPMA would have the UK seat at ESMA, and having the UKLA housed in a different body would risk diluting the UK voice in European debate.
- It is also important to have a commercially-oriented UKLA which is up to speed on latest market developments to ensure maintain an efficient and quick listing and capital raising process in the UK.
- Having two separate bodies involved in market regulation would run the risk of them adopting or implementing different or inconsistent policies on similar, overlapping or related issues. In particular, if the UKLA and the CPMA operated separately and independently of each other, companies would be at risk of double jeopardy, if conduct amounted to a breach of the Listing Rules prosecuted by the UKLA, and a breach of MAD prosecuted by the CPMA. It is unclear how these tensions would be resolved.

All of this would be damaging to attracting foreign investment in UK listed companies and detract from the UK as a place to invest. Instead we would favour the UKLA moving to the CPMA rather than being separated from the rest of the market regulatory structure.

Crisis Management

Learning lessons from the crisis, in particular the need for a coordinated response and clarity over “who’s in charge” is the right thing to do.

We welcome acknowledgement of the importance of European and international coordination, which will be critical to any response. A clear understanding of the interaction with the new European Systemic Risk Board and European Supervisory Authorities will be needed to ensure clarity over the actions required in the transition from ‘peacetime’ to ‘crisis’ conditions.

Conclusions

The CBI supports the government’s objective to ensure that changes to the UK regulatory framework increase financial stability. But this objective needs to be balanced with the need to promote economic growth, choice and responsible innovation in financial products, and maintain the UK’s competitiveness in financial services.

In particular we propose:

- A sharper clarity of mission and objectives for the proposed new financial architecture, which should start by articulating the vision for financial services in the UK
- Greater clarity over governance and accountability, to help address concerns over a concentration of powers
- The need for co-ordinated objectives and integrated systems to allay fears around regulatory double-keying and reporting
- A greater emphasis be given to the role that competition and choice can play, as well as consumer protection measures, in achieving good consumer outcomes
- More emphasis be given to the UK maintaining a powerful international and EU influence over financial regulation
- Careful handling of the transition to the new financial regulatory system to avoid distractions at a time when the financial sector is still in rehabilitation and so much regulatory reform is taking place, including internationally

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

Dear Sir/Madam

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

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

We welcome the opportunity to respond to this consultation on the reform of financial regulation.

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

1. Clarity for consumers:
The Banking Code outlined the rights and responsibilities of both consumers and banks and building societies. It has since been disbanded and replaced by the Banking Conduct of Business Sourcebook (BCOBS) and the Lending Code.

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

The Consumer Council has previously highlighted the potential problems of a dual approach in the regulation of personal current accounts. It is our view that splitting the role between two regulators is not conducive to effective regulation.

2. A robust and flexible system:
The system must be robust and flexible enough to respond urgently in identifying and taking necessary and appropriate action regarding financial products or behaviours that will cause customer detriment. The Consumer Protection and Markets Authority (CPMA) must ensure that the interests of consumers are placed at the heart of the conduct regulatory system and given the appropriate degree of priority. Splitting functions across a variety of bodies will require a very careful implementation to ensure a thorough, joined up system of regulation where important tasks and issues do not fall between the bodies.

3. Frequent reviews of the system:
Proper mechanisms must be put in place to review the regulation system and to take into account the views of consumers gathered by consumer representatives on a frequent basis. We have carried out research[1] that shows that consumers want to be involved in decisions and make their voice heard. For example, some consumers feel powerless in the face of big business and suspect that their views are not taken into account. The Consumer Council is willing to work closely with the Treasury to make sure that the views of consumers in Northern Ireland are represented and have an impact each time the regulatory system is reviewed.

[1] Consumer 2010: A Consumer Council research report into the attitudes and concerns of a Northern Ireland consumer in 2010.

4. Consumer protection and education:
The role of the new CPMA 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.

We welcome the establishment of the UK's first free financial advice service and annual financial health check to be set up by the Consumer Financial Education Body (CFEB). It is vital that CFEB continue the approach of working in partnership with organisations such as the Consumer Council to ensure there is a joined up approach and there are consistent messages on financial capability.

Further consultation with the Consumer Council:
We look forward to working with the Treasury and reviewing more detailed proposals, including the draft legislation.

We hope you will find this information useful. If we can provide you with any further information please do not hesitate to contact Maeve Holly, Senior Consumer Affairs Officer on 028 9067 4820 or by email, mholly@consumercouncil.org.uk

yours sincerely,

J. McCurley

JULIE MCCURLEY
Head of Money Affairs

CONSUMER CREDIT Counselling Service

A Registered Charity

HM Treasury
A new approach to financial regulation

Comments from the Consumer Credit Counselling Service

Introduction

The Consumer Credit Counselling Service (CCCS) is the UK's largest dedicated provider of independent debt advice, and a provider of generic financial advice. We are already working with HM Treasury on other topics, notably the future funding and delivery of debt advice. We welcome the opportunity to comment on HM Treasury's consultation on a new approach to financial regulation.

Given the services CCCS provides, we are particularly interested in the roles, powers and governance of the Consumer Protection and Markets Authority (CPMA), and how it will interact with the other new regulatory bodies.

Our starting point is that the CPMA must be a strong advocate for consumers. Many of those counselled by CCCS have been badly served by the financial services industry. In the current climate, we fear there may be pressures to put prudential concerns ahead of consumer concerns. We therefore greatly welcome the statement that the CPMA will be "a strong consumer champion in pursuit of a single objective".[1] In order to give consumers the confidence that they will be treated fairly, we believe it essential that the CPMA is established as the equal of the PRA and not its junior partner. Our responses reflect our support for this vision for the CPMA.

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 CPMA.[2] CCCS counsels clients on how to manage their consumer credit commitments and holds its own consumer credit licence. It has participated in recent discussions and consultations relevant to the regulation of consumer credit.

The consultation paper states that Government intends to consult on the merits of a transfer of responsibility for consumer credit from the OFT to the

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[1] Paragraph 4.3.
[2] Paragraphs 4.53 – 4.56.

new CPMA. CCCS believes the case for a transfer is strong[3], and looks forward to participating in that consultation. However, the outcome of the current consultation will shape the CPMA ahead of any transfer of consumer credit responsibilities.

Above all, we think it vital that the CPMA is set up in anticipation of the future transfer of consumer credit responsibilities. The range and complexity of consumer issues, and the risk of significant consumer detriment, are probably greater in consumer credit than in any other area of retail financial services.[4] The CPMA needs to be planned and established in anticipation of the responsibilities, challenges and opportunities that consumer credit regulation will bring. The planning needs to include work on the level of resources needed to regulate consumer credit effectively.

The responsibilities and challenges of consumer credit regulation are evident from data quoted in the consultation document, with the OFT regulating 99,000 firms compared with 29,000 at the FSA (16,000 jointly regulated).[5] Further, there are considerable problems with the consumer credit licensing regime, which, on the assumption it gains responsibility for consumer credit, we hope the CPMA will take early action to address. The scale of consumer detriment and need for firm regulatory action was underlined recently by the OFT's announcement that 129 debt management firms face losing their consumer credit licences unless immediate action is taken to comply with its Debt Management Guidance.[6]

We believe the Treasury should establish the CPMA as a consumer credit regulator in shadow form from the outset. At the very least, the CPMA should, from its inception, track developments in consumer credit and start planning for the full operational transfer of consumer credit responsibilities from the OFT.

Otherwise, given the other changes taking place at the OFT, there is a serious risk that consumer credit regulation will be neglected during a period when (as the OFT's recent view of debt management firms underlines) urgent work is needed. The Treasury itself is jointly undertaking with BIS the recently announced review of consumer credit and insolvency, the result of which are likely to have considerable consequences for consumer credit regulation.[7] Further, early engagement with consumer credit will help the CPMA to take forward more effectively related FSA work streams, not least the FSA's current work on responsible mortgage lending.

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[3] It is noteworthy that the powers of the new US Consumer Financial Protection Bureau (CFPB) include the consolidation of responsibility within the Bureau for consumer protection in respect of all financial services, including both mortgage and consumer credit lending.

[4] The challenges in consumer credit have been evident, for example, in the FSA's own extensive work to improve the sale of payment protection insurance allied to consumer loans

[5] Paragraph 4.54.

[6] http://www.oft.gov.uk/news-and-updates/press/2010/101-10

[7] http://www.bis.gov.uk/consumer-credit

With the prospect that consumer credit will be transferred to the CPMA, we are therefore keen to emphasise these points, comment on those parts of the current consultation most relevant to the CPMA, and more generally to ensure that consumer concerns are properly accommodated in the new regulatory framework.

We have responded to those consultation questions of most relevance to our work and interests.

Consultation questions

The Bank of England and Financial Policy Committee (FPC)

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

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

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

We believe the FPC should have regard to the interests of consumers in its decision-making. Paragraph 2.26 states that 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.

As part of the FPC's transparency and accountability mechanisms, the consultation proposes a six-monthly Financial Stability Report.[8] This could include an assessment of the impact of important FPC decisions during the period on consumers.

Prudential regulation authority (PRA)

4 The Government welcomes respondents' views on:

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

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

[8] Paragraph 2.53

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

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

We believe the PRA should have regard to the primary objectives of the CPMA. Indeed, it is difficult to envisage an effective working relationship between the PRA and CPMA if it does not have regard to the CPMA's primary objectives.

This relationship is particularly important in the current environment, where prudential reforms require banks to strengthen their capital ratios. There is potentially a tension between the prudential desire to see banks rebuild their profitability and the impact on consumers of the price and margin increases required to deliver this. For example, focusing on consumer loans, we have already seen a noticeable widening of interest margins since the financial crisis. Further, a minority of lenders continue to levy interest and charges on loans in arrears, even when CCCS has put in place sustainable arrangements for debt repayment.

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

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

Our preference is for the model proposed in paragraph 3.16. The risk of giving one authority responsibility for authorisation and removal of permissions is that (assuming the PRA were given responsibility) consumer concerns take second place to prudential concerns.

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

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

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

Consumer concerns may be relevant to some the key functions of the PRA listed in Paragraph 3.20, for example the approval of individuals to perform certain controlled functions within financial firms. There need to be mechanisms in place (as per Box 3.B and Paragraph 3.26) to ensure consumer interests are sufficiently protected and taken into account in the PRA's exercise of its key functions.

We believe the rule-making function should continue to be subject to statutory processes, with wider public consultation.

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

We believe the PRA should be as outward-facing as possible, with the accountability mechanisms set out in paragraph 4.36 applied.

While we welcome the fact that the PRA board will have a majority of non-executive members, we would like to see these positions filled through a process of open competition rather than Treasury appointments. We also recommend that non-executive members from a consumer background / with consumer experience are represented on the PRA board.

Consumer protection and markets authority (CPMA)

10 The Government welcomes respondents' views on:

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

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

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

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

The separation of prudential and consumer regulation does not, of itself, eliminate potential tensions between "the need to focus on the prudential health of regulated firms" and "the need to devote sufficient attention to the conduct of firms in retail markets".[9] Much depends on the relationship between the prudential and consumer regulator. If this is not balanced, ordinary consumers of retail products may continue to lack the degree of regulatory focus or protection they expect or require.[10]

[9] Paragraph 4.1.
[10] Paragraph 4.2.

It is noteworthy that in the United States the President himself, at the Signing of the Dodd-Frank Wall Street Reform and Consumer Protection Act that creates the Consumer Financial Protection Bureau (CFPB) commented that the new US consumer watchdog will have just one job: "looking out for people -– not big banks, not lenders, not investment houses -– looking out for people as they interact with the financial system."[11]

While, within the proposed UK framework, the CPMA should have regard to the stability of firms and the financial system as a whole, it must also be vigilant against firms justifying anti-consumer pricing and charging practices on prudential grounds (see above). The CPMA and PRA must have mutual regard for each other's objectives, with consumer protection not subordinated to prudential concerns.

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

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

As with the PRA, we believe the CPMA should be as outward-facing as possible. This will be essential for its credibility as a consumer champion.

As with the PRA, while we welcome the fact that the CPMA board will have a majority of non-executive members, we would like to see these positions filled through a process of open competition rather than simply Treasury/BIS appointments. As with the FSA, it is essential that people with a background in consumer advocacy are represented on the CPMA board.

We support the suggestion that the Consumer Financial Education Body (CFEB) CEO sits on the CPMA board.[12] We also note the recent introduction of a requirement on the FSA to have regard to the information provided by CFEB in pursuit of its consumer protection objective.[13] We believe this requirement should be retained for the CPMA, with CFEB encouraged to raise with the CPMA concerns and instances of consumer detriment it identifies in its work.

As regards the proposed statutory panels, our main interest is clearly in the Consumer Panel. We are pleased that this is to be retained. We believe members of the Panel should continue to be recruited through a process of open competition. We also believe it important that the Panel is adequately resourced, and mechanisms in place to ensure its research, findings and advice are given due consideration by the CPMA board and senior executive. Further, the focus and composition of the Panel will need re-assessment if

[11] http://www.whitehouse.gov/the-press-office/remarks-president-signing-dodd-frank-wall-street-reform-and-consumer-protection-act
[12] As suggested in paragraph 4.49.
[13] http://www.fsa.gov.uk/pages/Library/Communication/PR/2010/155.shtml

and when consumer credit responsibilities are transferred from the OFT to the CPMA.

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

If the CPMA becomes the fee- and levy-collecting body, it will be important to ensure that this does not compromise the independence of the other regulatory authorities and associated bodies.

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

No specific comment.

Markets and infrastructure

This section of the paper is not sufficiently relevant to our work and areas of interest for CCCS to comment.

Crisis management

This section of the paper is not sufficiently relevant to our work and areas of interest for CCCS to comment.

Consumer Credit Counselling Service
October 2010

Consumer Focus
Campaigning for a fair deal

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

October 2010

Introduction

Consumer Focus is the statutory organisation campaigning for a fair deal for consumers in England, Wales, Scotland, and, for postal services, Northern Ireland. We are the voice of the consumer and work to secure a fair deal on their behalf.

Consumer Focus has been active in the debate on regulation, developing sector-specific expertise on regulatory structures, cultures and methods and applying these in our work across the economy.

Our submission will essentially be focused on the Consumer Protection and Markets Authority (CPMA) but our comments apply across the structure. For the market to work it must work for consumers and citizens. There should be no fundamental conflict between prudential regulation and conduct of business regulation because both seek to protect consumers. Public policy considerations need to also be taken into account because of the nature of the sector and its importance to society and the economy. Divorcing these elements from the prudential aspects of regulation is to shut off important sources of information and risk indicators and to deny the broader impact of financial services.

The ideal regulatory structure would:

(a) put consumer interests first
(b) be transparent, open and accountable
(c) recognise its role in ensuring essential service provision and financial inclusion.

Other regulators start with an underlying obligation to people/consumers.

Ofcom's stated role is:

> *'We make sure that people in the UK get the best from their communications services and are protected from scams and sharp practices, while ensuring that competition can thrive. The Act (Communications Act) states that Ofcom's general duties should be to further the interests of citizens and of consumers. Meeting these two duties is at the heart of everything we do.'*

Ofgem's role is

> *'Ofgem is the Office of the Gas and Electricity Markets. Protecting consumers is our first priority. We do this by promoting competition, wherever appropriate, and regulating the monopoly companies which run the gas and electricity networks.'*

Assessment Criteria

In our response to this consultation we will be using a set of analytical criteria developed as part of a robust review of regulators conducted by Consumer Focus last year. *Rating Regulators*[1] analysed six key regulators, including the Financial Services Authority.

Our assessment framework consists of twenty indicators which together form the essential building blocks of a consumer-focused regulator. These are:

Legal framework

- statutory objectives and duties enable the regulator to adequately promote the interests of all consumers
- responsibilities between different actors are clearly defined, without gaps or overlaps
- structures are sensitive to devolved contexts
- the right tools for the job

Culture and accountability

- translates statutory objectives into consumer-focused priorities and values
- embeds a consumer focus across all levels of the organisation
- transparent about its activities
- accessible to the general public, including disabled users
- works effectively in a devolved setting

State of readiness

- identifies likely sources of consumer detriment, both now and in the future, which shapes work priorities
- uses effective mechanisms to understand the consumer perspective and translate this insight into sound decisions
- works effectively with others, including with consumer organisations
- influences the wider regulatory agenda

State of action

- empowers consumers to help achieve regulatory outcomes
- has effective incentives to encourage compliance with its rules
- chooses the appropriate regulatory approach in the circumstances, and intervenes in a timely fashion when needed
- gives priority to, and intervenes effectively on behalf of, consumers who are vulnerable
- uses enforcement tools when necessary to protect consumers

Impact and learning

- defines and measures its impact on consumers in terms of outcomes
- evaluates its work and embeds learning

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[1] Consumer Focus, *Rating Regulators,* February 2009.

Regulatory principles

The current regulatory thinking, borne of an environment of budget cuts and efficiency, should not place a straightjacket on creative approaches and possible solutions in financial services. Regulators and policy makers should not be subject to the ebb and flow of regulatory rhetoric but rather need to assess the appropriate responses to each particular situation within the policy framework set. In the aftermath of a crisis quite different responses are required to those that may be called into play when the market is working well for consumers and the economy.

The proposed reform of financial services regulation has a dual role:

(i) responding to the current crisis and seeking to prevent future crises
(ii) focused on developing the best regulatory structure to promote a competitive consumer focused and socially useful market, one that is innovative and attractive to investors

The adjustment required in (i) may be specific and short term and therefore different to that required in (ii). We see future development of regulation as requiring two distinct stages with the first requiring some extraordinary measures and bold intervention until the market normalises or stabilises and has developed a maturity that sees market forces as a key regulatory factor. Without recognition that some significant change and intervention may be needed in the first instance it is unlikely that we will get to Stage 2.

> The Food Standards Agency was set up in 1999 in the aftermath of the BSE crisis. It has a clear mandate to put the interests of consumers at the heart of regime in order to restore public confidence in food safety. Its origins have much in common with the current situation in financial services. It is now recognised as an exemplary regulator.

Cost and global competitiveness

It is particularly important that these regulatory changes are absorbed and not passed on to consumers. The burden of regulation is already borne significantly by consumers and the state through bail outs and cheap money, low returns on savings and limited lending facilities. There will be an opportunity for review when the market starts delivering for consumers and pricing better reflects costs and genuine competitive forces. The industry as a whole, and its individual players, can lead in this area and therefore it is within their power to deliver an environment where the regulatory burden can be reduced.

The global crisis has fostered a more uniform approach to regulation which will hopefully limit the extent and risks of regulatory arbitrage. As a financial centre it is unlikely that our competitiveness will be reduced and undermined as a result of good regulation. London has significant advantages as a financial centre such as language, time zone and well established infrastructure that will continue to support its strong position.

Interaction and responsibilities of the three financial regulatory bodies

The twin peaks structure proposed, in recognising the fundamental difference between prudential regulation and conduct of business regulation and giving regulators clear objectives, promises to overcome some of the problems in the current single regulator system. The challenge will be co-ordinating the views of the different agencies and resolving conflict.

The foundation for this structure should be clear public policy objectives and accountabilities. Our experience across different sectors is that the high-level objectives of Government are rarely fully articulated, even in statutes, with the result that decisions can too often be made on the basis of inter-organisational politics and individual regulators' preferences and cultures. This can create confusion, overlap and two significant gaps: a strategy gap and an accountability gap. These are dangerous enough when there is only one regulator, but their likelihood and impact are heightened in markets where there are two or more regulatory bodies, as will be the case in financial services.

We therefore propose that Government periodically issues a strategic statement, setting out what it expects the regulators to deliver and what the government's own role will be. Implementation is then a matter for the regulators, working within the strategic framework set by Government. This allows for clear accountability to the elected government, while making the most of the specialist skills and expertise within the regulator[2].

Responsibilities between the different components of the regulatory system must be clearly defined, without gaps or overlaps. There are a number of areas where there are overlaps; such as in relation to supervision of firms where the Prudential Regulation Authority (PRA) and CPMA, or the Bank of England and CPMA have an interest. It is unclear how these will be resolved and which organisation's objectives will apply. In other areas there is a separation of responsibility which could compound the current problems with consistency and co-ordination, such as the proposal for a split of licensing responsibility between PRA and CPMA, in addition to the existing separate system for credit licensing. And there is the blurring of the intended split between prudential and conduct responsibilities, with the CPMA continuing to be the prudential regulator in those areas not covered by the PRA.

It seems the intention is to move towards objectives-based regulation but the proposal still has remnants of activity-based regulation and a further distinction based on the type of business. This could lead to duplication of the burden on firms and inaction as a result of confusion over responsibility.

[2] Consumer Focus Fresh Thinking, *Regulating in the consumer interest, March 2010*

There are lessons we can learn from other jurisdictions. The Netherlands has a twin peaks regulatory structure. This model of regulation works well because it ensures that each regulator has a clear focused sense of purpose, and 'should never be in a position where it is tempted to sacrifice the goal of transparency to prudential concerns and vice versa'.[3] The overlaps in the proposed system need to be clarified.

The proposed system implies a precedent with the Financial Policy Committee (FPC) and PRA having the upper hand and so is not a pure twin peaks model. The CPMA must have regard to the FPC and PRA objectives and is required to consult with the other bodies in relation to impacts on these but the obligation is more limited in the other direction. Our concerns about the separation echo a previous comment by Clive Briault, the former Director of Prudential Standards at the FSA, in that 'the outcome may reflect the balance of power between different regulators at a particular point in time, rather than a rational and coherent consideration of the problems.'[4] The CPMA must have sufficient tools, independence and powers to properly carry out its consumer protection functions, and in this respect they should be at least equivalent to those of the PRA.

A report on the twin peaks model to the Canadian Expert Panel on Securities Regulation suggests the need for a permanent co-ordinating body that will promote co-ordination of regulatory policy, sharing of real-time information and co-operation on enforcement matters. The body should not be ad hoc and co-ordination between bodies should not be left to an agreement between them[5] but rather co-ordination should be by an independent legal authority which would 'have automatic access to the other's reports, work together on new rule making and co-operate on enforcement and supervisory matters.'[6] A formal mechanism for co-ordination and conflict resolution needs to be put in place at the outset of a new structure.

While we welcome the focused attention on consumer protection issues we are concerned that the CPMA perspective will be undervalued or lost in the event of a conflict.

The House of Commons Regulatory Reform Committee has recommended that the Better Regulation agenda post financial crisis needs 'a greater diversity of input, including more accountability to citizens and end users'.[7] All three bodies need clear public interest and consumer representation, as well as the cross-representation between the regulators, to ensure their perspective is broader and they have access to the best information. All three should be required to consider the consumer interest and there needs to be a clear authoritative mechanism to resolve conflict.

The respective Boards should have a variety of knowledge and skills and in addition to cross-representation need to include those with consumer, public policy, regulatory, economic and industry expertise as well as those who are able to represent the interests of the nations. They need to be cognisant of each other's work and facilitate an open exchange of information. At executive level the agencies need to be led by high profile and influential figures. Hector Sants' appointment to the PRA should be mirrored by a similar status appointment to the CPMA.

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[3] Hans Hoogervorst, The Chairman of the Netherlands Authority for Financial Markets, *Dutch regulator says 'Twin Peaks' supervision best*, **http://reut.rs/c7hu23**

[4] Clive Briault, *Revisiting the rationale for a single national financial services regulator*, FSA Occasional Paper, February 2002.

[5] The Australian system utilises a memorandum of understanding.

[6] Eric J. Pan, *Structural Reform of Financial Regulation in Canada*, A Research Study Prepared for the Expert Panel on Securities Regulation p.42.

[7] House of Commons Regulatory Reform Committee, *Themes and Trends in Regulatory Reform*, Ninth report of Session 2008-2009, July 2009.

The Bank of England and Financial Policy Committee

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

  Consumer interests need to be considered throughout the regulatory system and at the FPC level should be reflected in consideration of stability and sustainability issues and in relation to market and public confidence. Rebuilding this confidence should be an immediate priority.

  Confidence in financial services involves a wide range of factors and conflicts including confidence between institutions, as well as the confidence of users (and issues such as runs on assets which can in turn lead to system instability).

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

  Public interest and trust and confidence should both be 'have regards to' matters. In general these issues will be dealt with through a clear Government public policy framework but the FPC will have a role in alerting the Government to implications of policy or lack of policy on financial stability and vice versa.

Prudential regulation authority

4. The Government welcomes respondents' views on:

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

  Statutory objectives need to be clear and unambiguous, recognising that the different agencies have different functions. One of the criticisms of the FSA has been that there are too many objectives with no weighting or prioritisation, and focus on one tended to lead to neglect of another. The overarching and consistent objective should be promoting and protecting the interests of consumers..

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

  The principles generally seem prudent and sensible but their execution needs to be on the basis of broad evidence and transparent decision making. There is a danger that consideration of the need to use resources in the most efficient and economic way is interpreted in such a way that constitutes a restraint on exercising powers, and that consideration of the burdens or restrictions imposed is conducted in isolation of the benefits or in underestimation of benefits that may not be easily quantified or that don't have such influential and well resourced advocates.

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

  The FSA was reluctant to intervene in markets, giving emphasis to innovation which had its expression in exuberant risk taking rather than new products and services designed for the demand side of the market. Part of the reluctance may have been due to the criticism by industry that intervention was likely to inhibit competition. The danger of competition as an objective of the regulator is that the regulator moves into the role of promoting the industry. Competition of itself should not be an objective but one of the mechanisms to deliver outcomes for users. It's value in achieving this needs to be monitored and supplementary or alternative tools used where outcomes are not being achieved.

  Taking into account the desirability of maintaining the competitive position of the United Kingdom was in direct conflict with a broader competition objective. The lack or failure of competition has been a key issue in the sector for a number of years with consolidation increasing and little diversity in products and models. These factors need to be reviewed.

  It is important that the statutory provisions supporting the new regulatory structure provide for consideration of the impact of its regulatory activities on competition. This should be supported by a greater role for stakeholders, including consumers and consumer groups, to raise competition issues in relation to financial services. The promotion of diversity and products available to meet the needs of different groups of consumers should be a strong public interest consideration in supporting consumer protection and confidence in the market.

While competition underpins functioning markets, it is a means to an end and so should not take priority over other objectives. We believe there are advantages in competition being dealt with by a specialist body to ensure consistent approaches are taken to competition and market issues across sectors and in order to better deal with cross market issues. It allows the regulator to get on with regulating.

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

The societal implications of the failure of financial markets, and the significant taxpayer investment in the market, underline the need for consideration of defined public interest objectives in regulating the area and regular assessment of outcomes against these objectives. It is clear that there is need for a culture change and a need to address what Adair Turner has referred to as the 'social uselessness' of parts of the sector,[8] indicating problems with the fundamental operation of the market. The sector does more than just provide us a range of products and services that are optional. It provides essential services, fundamental to the broader economy, and because of this the terms on which they are provided need to be monitored.

Few people now trust the banks to do what is right.[9] Trust and confidence in the sector fell by 11 per cent between 2008 and 2009. For those big brands directly associated with the crisis the fall was much larger.[10] Research by CII shows one in five UK consumers believe that they will never trust financial services again.[11] Without restoring confidence some of the important public policy goals that are central to reviving the sector will be lost. Promoting a savings and banked environment and sustainability in the social, economic and environmental sense is a key to recovery and a more stable system for the future and should be at the heart of what the PRA does.

Public policy considerations feature in the Canadian financial system, which is notably risk averse and also has been relatively unscathed by the recession. There is a great emphasis on savings and the savings culture is generally more sustainable and long term. Consumption is more heavily taxed than savings and income, and there are no particular tax incentives associated with home ownership. As a result Canadian institutions remain reasonably well capitalised and Canada did not experience a bubble and burst in house prices.12 The regulator needs to have a strong public policy framework and clearly operate in the public interest.

In addition to the principles in section 2 we would suggest adding the following as matters to have regard to:

(a) the public interest, including:

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[8] Adair Turner, *What banks do, What should they do and what public policies are needed to ensure best results for the real economy?* Speech to Cass Business School, 17 March 2010.

[9] The Edelman Trust Barometer shows that since 2007 this has plummeted 20 points from 41 per cent to 21 per cent in the UK, **http://bit.ly/aPReOH**

[10] Milward Brown OptimorBrandz, Top 100 most valuable brands 2009

[11] CII/YouGov 2009

[12] Pietro S. Nivola and John C. Courtney, *Know Thy Neighbour: What Canada Can Tell Us About Financial Regulation,* The Brookings Institution, April 2009; **http://bit.ly/aJrdnw**

- the public perception of the market and in particular, the fairness of the market
- furthering the interests of citizens and consumers
- promoting a sustainable market and products and services (including consideration of long term impacts such as broader social, economic and environmental impacts)
- regulating essential service provision
- furthering the interests of vulnerable and disadvantaged consumers

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

We already have two licensing systems in retail financial services which operate in different ways. Introducing a third, with a further set of objectives, is likely to increase the regulatory burden and lead to further inconsistency, lack of co-ordination and barriers to entry. It is important that authorisation/licensing standards are consistent across the board but there is the capacity to differentiate in standards and regulatory requirements in terms of risk. A joint licensing and review board, responsible for authorisation and removal, is a preferable option.

The licensing system itself has the potential to better shape the sector in a way that is more responsive to market and consumer issues. Reform of the licensing system would provide an opportunity to reconsider the objectives of licensing and its potential as a regulatory tool to drive a fairer market place. Key elements such as judging the integrity of a firm as part of the authorisation process, as suggested recently by the Chief Executive of the Financial Services Authority[13], and looking at fairness and consumer and market factors as threshold conditions provide a basis for these to be monitored on an ongoing basis. Regular reviews with the power to remove licences or alter the licence conditions where threshold conditions are not being maintained or practices are called into question would better support the current supervisory system.

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

<u>Powers and functions of the PRA</u>

The Financial Services and Markets Act 2000 (FSMA) provides a useful starting point as a template, bearing in mind that this formed the underpinning of a regulatory system that was not appropriately equipped to deal with the financial crisis. In some instances the tools were there but there was hesitancy in using them[14] (and in some instances concerns about the legal basis for such powers such as the publication of information on investigations and the previous s.404 power), in others the tools need to be enhanced.

The adoption of FSMA provisions should first consider how or if they have been utilised at all or effectively and remove any impediments to their operation. A strict separation of conduct and prudential powers will need to be considered carefully as there is necessary overlap and a need to co-operate and exchange information on these.

[13] Mansion House Conference on Values and Trust, 4 October 2010.
[14] Particularly in areas such as PPI, unfair charges and where there was evidence of practices that breached the treating customers fairly obligations.

There is an anomaly in the PRA authorising some institutions but not supervising them. It is likely that there will be differences in the application of the threshold conditions and requirements for ongoing satisfaction or review of these conditions if responsibility is split between 2 regulators.

Rule making

While wide consultation is necessary in carrying out the conduct of business rule making function, the consultation should not be such that it is in effect a substitute for action where there is evidence available on which to act. The consultation process itself can be subject to delays which of themselves can impact on the stability of the system.

Where intelligence gained through supervisory and enforcement activity and analysis of monitoring and complaints data reveals a real problem it requires an efficient response. We have seen the problems that arise through lack of action in the areas of mis-selling of PPI insurance and unfair charges, areas that could also have been addressed through using the wider implication process. Unfair or risky practices have the potential to impact on the stability of the system through fostering models that are unsustainable. The regulator must have, and must be prepared to exercise, an effective wider implications power. We are hopeful that the recently amended s404 will be utilised by the new regulator.

Where consultation on rule making occurs it must be open and transparent, showing clearly who has been consulted and the evidence provided. Evidence needs to be analysed and balanced and reasons given for any decisions made as a result of the consultation. We have been critical of the FSA being subject to industry capture. Consumers need to be engaged and informing these processes and consultation with the Consumer Panel, in addition to other consumer bodies, should go hand in hand with consultation with the Practitioners Panel.

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

Our general views on transparency and accountability across the regulatory structure are contained in our response to question 11.

Our concern with the placement of the FPC and PRA in the Bank of England is that central banks have never been particularly open or transparent about their operations and the perception of the Bank acting as an 'advocate of City interests within the Government'[15] remains. We will need to see, in the words of the IMF, robust mechanisms to ensure transparency and a high degree of accountability of the Central Bank's actions in practice. There should be the same level of accountability across the regulatory structure.

[15] John Kay in The new financial services leviathan: has competition been a casualty of the financial crisis, in Consumer Focus, Rethinking Financial Services. June 2010.

Consumer protection and markets authority

10. The Government welcomes respondents' views on:

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

  We propose the CPMA objective should be re-framed so that it has the primary objective of protecting consumers and promoting consumer interests while having regards to confidence in financial services.

  The regulator should have clear statutory objectives primarily focused on the consumer interest.[16] The FSA currently has five objectives that are not weighted, where the discretion as to which has priority is left to the regulator. Objectives should be clear and unambiguous and where there is more than one they should be prioritised so there is sufficient guidance to and accountability of the regulator.

  The organisational structure appears to subjugate consumer interests to other interests. Financial stability is fundamental to consumers in terms of the provision of low risk sustainable products and services that are both essential to their engagement with society and the economy and fundamental to the long term recovery and restoration of confidence. In many cases these interests will coincide but when they don't it appears the matter becomes a public policy issue and should be referred to the Government of the day. For example where a firm's survival or the survival of the prevailing business model of firms may be impacted by consumer protection measures or risk measures, should it really be consumers or citizens that suffer?

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

  The principles seem prudent and sensible but their execution needs to be on the basis of broad evidence and transparent decisions. There is a danger that consideration of the need to use resources in the most efficient and economic way is interpreted in such a way that constitutes a restraint on exercising powers. Consideration of the burdens or restrictions imposed must not be conducted in isolation of the benefits or in underestimation of benefits that are either difficult to quantify or that don't have such influential and well resourced advocates.

[16] Consumer Focus, *Regulating in the Consumer Interest*, March 2010.

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

  Innovation should be consumer focused and have consumer benefits – impacts on innovation should only be considered after weighing the benefits to the consumer of innovation against any detriments (such as reductions in protection or particular impacts on segments of the market, particularly vulnerable and low income consumers). Innovation in the sector has increasingly been about gaming the market and not delivering for the consumer.

  What is needed is innovation that promotes choice and offers real value for consumers, innovation that fosters good personal financial management so that consumers are able make appropriate choices throughout their adult lives.

  The FSA was reluctant to intervene in markets, giving emphasis to innovation which had its expression in exuberant risk taking rather than new products and services designed for the demand side of the market. Taking into account the desirability of maintaining the competitive position of the United Kingdom was in direct conflict with a broader competition objective. The lack or failure of competition has been a key issue in the sector for a number of years with consolidation increasing and little diversity in products and models. These factors need to be reviewed.

  It is important that the statutory provisions supporting the new regulatory structure provide for consideration of the impact of its regulatory activities on competition. This should be supported by a greater role for stakeholders, including consumers and consumer groups, to raise competition issues in relation to financial services. However, we believe there are advantages in competition being dealt with by a specialist body to ensure consistent approaches are taken to competition and market issues across sectors and in order to better deal with cross market issues. It allows the regulator to get on with regulating.

  The Canadian system provides a good example of where good regulation promotes a market that works for consumers even in the absence of competition. Canada's banking sector is very concentrated, led by five major banks involved in combined activities, but the customer experience in relation to most measures of consumer welfare – service fees, credit card costs, interest spreads on intermediated credit, etc – compares favourably with those in other advanced countries.[17]

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

  We suggest adding the following as matters to have regard to:

  (b) the public interest, including:

  - the public perception of the market and in particular, the fairness of the market
  - furthering the interests of citizens and consumers

[17] Pietro S. Nivola and John C. Courtney, *Know Thy Neighbour: What Canada Can Tell Us About Financial Regulation,* The Brookings Institution, April 2009; **http://bit.ly/aJrdnw**

- promoting financial inclusion, and in particular the interests of vulnerable and disadvantaged customers, by encouraging access to suitable and affordable products and services
- promoting an economically, environmentally and socially sustainable market and products and services
- regulating essential service provision
- promoting public understanding of the financial system (meaning accessibility, understanding of products and pricing, complaints and redress mechanisms, openness and transparency of regulators and service providers)
- promoting diversity in the financial services sector

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

An effective regulator needs to:

- detect systemic risk issues before they become entrenched
- enable early intervention in relation to unfair practices such as the mis-selling and unfair terms and conditions associated with PPI
- investigate models that are unfair, hamper choice and obstruct good personal financial management, such as the hidden charges model in the provision of current accounts
- consider areas where uncertainty and lack of control over payments negates financial capability

Setting standards, supervision and enforcement

The new regulation should see the development of an effective radar to identify hazards, risks and practices before they become entrenched.

The stated new approach to Retail Conduct of Business holds out the promise of intervention on price and products, recognising and responding to 'some of the unique characteristics of retail financial services that call for a more intrusive approach'.[18] These changes will require greater interrogation of firm's business models and strategies to minimise the risk to both consumers and the system. While this model is not new to prudential regulation, which monitors closely and pre-empts hazard, the new conduct approach will require a complete culture change from the regulator and new skills and ways of thinking. It is important that the foundations for culture change are laid early lest the new regulator appears as the same body with a new set of clothes.

We welcome the commitment to a strong and credible enforcement function, part of this will be clarity of objectives and the powers and tools to carry these out, part will be the practice, and part will be the public policy framework that supports the regulator and is resistant to lobbying and short term gains. We have been critical of the FSA in its failure to use its existing tools such as the capacity to intervene through the authorisation standards and reviews where practices or models are not sustainable, and to utilise the wider implications and the information and investigation powers. And there are some useful new tools in the amendments to the FSMA that came into force in June this year that should not be left to rust, such as the power to impose suspension or restrictions on authorised persons (which could be suspending a firm from selling a particular product), and removing the previous restrictions on imposing a financial penalty and withdrawing a person's authorisation.

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[18] HM Treasury, *A new approach to financial regulation: judgement, focus and stability*, July 2010

The US Consumer Financial Protection Bureau has been given specific powers in this area and will be able to autonomously write new rules to oversee and govern faulty financial products. We need to be sure that current and proposed powers give this level of clarity.

<u>Transparency and empowering consumers</u>

Transparency in the exercise of its functions is vital. The FSA has been a reluctant reputational regulator. It does not reveal details of investigations until concluded, nor does it provide information about the firms that are not satisfactorily complying with requirements.[19] Positive steps have been made recently with the requirement on banks to publish complaints data but more and better information is needed so that consumers can make real choices and businesses are more motivated to treat their customers fairly.

The regulator should be open in its investigations and regulatory activity and therefore accountable. Reputational regulation may, in itself, help develop a trusted brand approach in the industry.

The FSA has indicated that the FSMA and other laws prevent them from both disclosing early information about enforcement action and the compliance records of firms. The Information Commissioner's decisions in relation to freedom of information applications reveal that different legal interpretations exist.[20] It shows the influence of the industry and the timidity of the regulator that FSA have not even tried to exercise its powers in this respect. It is also a signal that the future regulatory regime should not only ensure justice is done but must be seen to be done and that any suggestion of legal impediments needs to be removed through clear drafting of powers.

The industry is concerned about reputation, however there is no reason the financial services industry should not be subject to the same rules that any firm facing civil action is subject to. The OFT Supreme Court action on unauthorised overdraft charges identified firms at initiation of action. Although the action was unsuccessful it provided valuable information to consumers about how different firms were dealing with them and consumers themselves became part of a public campaign to address unfairness in the system. It had an impact on firm's behaviour, at least in the short term while there was threat of an adverse decision, and brought charges down, as well as resulting in agreement about greater transparency of charges.

Civil cases and enforcement actions take years to complete and even then often go on to appeal. In a market where consumers are unlikely to initiate individual civil actions against their banks it is up to the regulator to make positive interventions in the market and for these to be transparent in order to empower consumers to make their own assessments.

The Australian regulator, ASIC, will be empowered under the Corporations Amendment Regulations 2010 to publish infringement notices. Under the regulations firms are issued with an infringement notice where ASIC believes that they have contravened the Act and are given the opportunity to remedy the contravention through complying with the infringement notice within 27 days. At the end of the compliance period, whether there has been compliance or not, ASIC may publish the infringement notice. *Section 7.2A.16*

[19] Ibid
[20] Ibid

A culture of publishing and analysing compliance, complaints and enforcement actions to identify emerging risk and as a window on the industry is vital. It is also central to the regulator's activity and to developing an understanding of the role of the regulator. Consistent standards on publishing information need to be adopted across the regulatory environment and the greater co-ordination between roles the development of processing one data base of information.

In light of the CPMA's main objective of promoting consumer interests, the separation of prudential regulation, and the greater power and propensity to intervene early to prevent unsustainable practices and products from gaining a foothold there seems no reason that the CPMA should not become an exemplary reputational regulator.

The Conservative White paper for sound banking expressed support for this principle in stating: 'We will ensure that the CPA names and shames firms which break the rules. This will act as an incentive for firms to improve their behaviour.'[21]

Naming and shaming or naming and faming is used successfully by other UK regulators to provide information to empower consumers. Both Ofcom and Ofgem name firms at the time of launching investigations. Ofgem also rates performance thought its annual quality of service reporting and the Food Standards Agency publishes performance measures via its traffic lights system and their Scores on the Doors initiatives.

Impact and learning

The ambition of regulation must be to change the culture and norms of industry so that businesses start to act in the spirit of the governing rules rather than seeking to merely meet the letter of those rules and test the boundaries of what they can get away with. The principles based approach within the FSA has been accompanied by an outcomes performance report, a commendable approach which did however need more work in terms of how outcomes were measured. It is important that high level principles such as Treating Customers Fairly actually deliver outcomes, rather than imposing a regulatory burden on firms which has no impact on culture and actions. It appears that more guidance in this area is necessary and some clear incentives or disincentives applied to encourage behavioural change.

Ofcom uses its consumer experience reports to evaluate the impact of their regulatory policies and activities on consumers, providing them with a means of translating consumer insight into decision making. Ofgem has a reporting framework for its social and sustainable initiatives that measure performance against a range of indicators.

Enhancing the own initiative variation of permission (OIVOP) powers to enable supervision to feed into regular review and to maintain standards will be significant in the CPMA's ability to provide effective consumer protection and to promote a sustainable market that better serves the public interest.

[21] Conservatives Policy White Paper, *From Crisis to Confidence: Plan for Sound Banking*, July 2009.

Remedies and redress

The CPMA should be more focused on the impacts of the system and behaviours and practices on consumers. Restitution orders need to be better utilised and more information should be available to consumers about how to seek these.

Mechanisms for collective action and redress and powers to act in situations that are likely to result in mass harm and have wider implications are fundamental to both efficiency and trust and confidence in the new system. There is a great consistency about the complaints in the financial services area, centring around particular products and practices. PPI and current account charges top the polls year after year. If the regulator is not going to act, then consumers need efficient procedures to initiate action and seek redress where the loss to individual consumers is small and therefore uneconomic to pursue. It is an important deterrent to poor business practices.[22]

We do not want to see the regular emergence of a mis-selling scandal or unsafe practice involving high consumer detriment and huge numbers of complaints to the FOS. As Adair Turner comments, 'this periodic process of large scale customer detriment and then customer compensation is not an acceptable or sensible model for the future.'[23]

Accountability and accessibility

The regulator needs clear accountability processes to foster its legitimacy, providing information about working methods, decisions, reasons for decision and how performance is measured so that organisations, the public and the media can scrutinise its work and to ensure it is free from bias towards influential interests.

A regulator needs to consult widely and decide openly on the basis of its consultation and information gathering. FSA produces documents often in technical language and does not publish responses to public consultations, a step we called for in *Rating Regulators* over a year ago[24], and so it is sometimes difficult to see the weight of evidence behind decisions and there is the perception that decision making is very much behind closed doors. A regulator needs to be both pro-active in collecting information and responsive in receiving it. Consideration of the internal advice from panels, the external information from stakeholders as well as the commissioning of independent information gathering is fundamental. How this information is then used to make a decision is also important.

Board and management structures need to retain and enhance the current consumer representation, and the executive committee with responsibility for taking significant supervisory and regulatory decisions needs to have membership with an understanding and experience of consumer issues as well. In addition to an internal consumer perspective there needs to be an obligation to consult widely with stakeholders and those affected by the regulator's decisions. The Board should hold public board meetings and publish its papers in advance in line with regulatory best practice.

> The Food Standards Agency invites the public to attend open Board sessions which are held at venues across the UK. A question and answer session is held at the end of Board meetings, at which members of the public can raise issues of concern. Board meetings are also webcast and there is a freephone listen-in service to ensure that cost is not a barrier to anyone who wants to engage in the decision-making process. Minutes of meetings between senior staff and key stakeholder groups are also made available on the Agency's website.

[22] In the absence of Government action in Australia consumers have joined forces in a class action in relation to unfair bank charges, significant cuts in fees have been made recently by the banks concerned in response to the public outcry. **http://bit.ly/bs7LGn**
[23] FSA Annual Report, 2009/10
[24] Consumer Focus, *Rating Regulators, Financial Services Authority*, February 2009.

We welcome the accountability mechanisms proposed in terms of corporate operations, and in particular reviews by the National Audit Office. These mechanisms should apply throughout the regulatory structure.

In order to be accountable to the public the regulator needs to be accessible to the public and provide information in a timely and comprehensible way for a range of audiences, not just for the industry. It needs to do more than sit at Canary Wharf in the middle of its industry. It needs to engage and provide real opportunities for consumers to contribute to the work on the CPMA. Its engagement strategy should provide:

- Opportunities to engage in the CPMA's corporate planning processes to allow consumers to help shape the priorities of the Authority
- A 'consumer radar' of emerging issues and areas of detriment
- The ability to work both with representative bodies and directly with consumers themselves

With much of the communication and consumer expertise moving across to CFEB the new regulator has to reinvent itself and look at how it communicates and interacts with the broader community. The advantage of a CPMA will be a consumer focus but it needs to be able to relate to consumers, to promote itself and to understand their perspectives. It needs a diversity of staff from different backgrounds who can take a wider and more relevant approach. This includes those with financial services expertise as well as public policy and regulatory experts[25] and consumer experts.

To complement and inform the regulatory role informal and accessible mechanisms for dealing with complaints need to be available. The role of the FOS in safeguarding the consumers interests is of vital importance and it must be adequately resourced to do its dual job of protecting the interests of individual consumers and gathering information on potential areas of detriment that need urgent attention by the regulator.

Given the split in regulatory functions (particularly between credit and deposit taking) and the rather confusing plethora of regulatory rules there is a strong case for a single point of contact for consumers to provide consumer friendly information and refer to the appropriate body. There should also be an obligation to produce uniform complaints information to provide consumers clear guidance about where and how they can complain.

Credit

Although we are aware that regulation of credit activities will be the subject of a separate consultation it seems a missed opportunity that it is left out of this exploration of regulatory reform. The impact assessment has assumed that the CPMA will be responsible for consumer credit regulation. Both Coalition parties expressed a commitment to resolving the anomalous situation of retail banking regulation being split between two regulators. A new consumer regulator should absorb regulation of credit functions but be mindful that consumer regulation requires a different approach. In many ways the OFT was much more focussed and accessible in its regulation, mindful of consumer and market factors as important considerations in the licensing process, and more likely to take enforcement action when things went wrong. We would want the advantages of the credit licensing system in this respect to transfer to the CPMA.

[25] See Mervyn King's evidence to the Treasury Committee on 6 August 2010.

Devolved working

Even though financial services are a reserved matter, it is important to embrace a genuinely UK-wide culture and for the regulator to respond to possible differences in the needs of consumers in the nations. They should also be mindful of impact on consumers of the differences in the legal system in Scotland. If regulators are not sufficiently tapped in to the policy environments of the nations they risk taking decisions that have unintended negative consequences in these arenas. Successful devolved working would include a physical presence in each nation, board members drawn from the nations, engagement with national decision makers and stakeholders, research on and targeting of particular issues, and reporting specifically on activities in the nations.[26]

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

We agree that the panels are an important consultative mechanism and we support retention of the Consumer Panel within the CPMA but with a wider remit to hold discussions on pertinent issues with the PRA and FPC. We have had little interaction with, and limited knowledge of the work of the Practitioner's panel and the Small Business Practitioner Panel but are optimistic that in a Consumer Protection Authority that will change. In a consumer focused regulator these bodies need to more than a mouthpiece for industry but must be transparent in promoting best practice in customer service and customer focused innovation. While the Consumer Panel provides evidence based proposals through a body of independent research, the other panels seem to provide a more subjective view through the opinions of their constituents. It is hard at times to distinguish these roles from that of industry bodies as a result.

There needs to be an opportunity for the panels to test their views against each other with the possibility of coming up with workable solutions that recognise the others interests, rather than the shuttle diplomacy approach that is common. And the accessibility and transparency provisions need to apply equally to the Panel's work and to the FSA's considerations of their input.

The Consumer Panel is seen as one of FSA's current strengths but it is also important that the regulator liaise with external stakeholders to get a broader view and a better understanding of the views of consumers. Regulation needs to be designed around the needs of those it is meant to benefit and this requires a direct dialogue with consumers and their representatives.[27] As consumers may not seek out the regulator and consumer groups may not have the resources to engage in the same way as business interests, the regulator should be pro-active in consumer engagement, seeking out consumers where they live and on their terms to ensure genuine engagement. External perspectives need to be sought in relation to the individual experiences of consumers as well as alternative policy perspectives and models developed from experience and understanding of different markets and different interests. There is a concern that these broader views may be lost in the efficiency drive that is the Government's consumer landscape review and that the already strong and influential voices of industry will not be sufficiently countered.

We have been critical of the FSA not having a formal programme of consumer research outside its financial capability area. This gap will become particularly apparent with the capability work moving to the CFEB. In *Rating Regulators* we commented that:

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[26] Consumer Focus, *Rating Regulators: Financial Services Authority*, February 2009.
[27] Consumer Focus, *Rating Regulators: Financial Services Authority*, February 2009.

‘The absence of an annual research programme, in the mould of Ofcom’s Consumer Experience Report, appears to limit the FSA’s ability to maintain an overview of consumer attitudes and experience across its remit and over time.’[28]

We would encourage the regulator to develop a research programme that included deliberative as well as qualitative research and for important sources of consumer information such as complaints data to be properly analysed rather than just remaining a numbers exercise.

Ofgem launched a programme called *Consumer First* in 2007 which is designed to lead to ‘a qualitative improvement to decision making’ using qualitative and quantitative research and exploring the needs of different sectors of the market, and in particular those of vulnerable consumers. They have a Consumer Challenge Group, a panel of consumer representatives with expertise on energy issues and have also recently recruited a Consumer panel comprising 100 ordinary domestic consumers to act as a sounding board for Policy development. Ofcom use a similar mechanism in their citizen jury to provide feedback and input into decision making.

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

We support the FSCS remaining a single scheme under the remit of the CPMA who should have the capacity to consider the appropriateness of cross-subsidies (particularly if there is a move to ring fencing risk through narrow banking) and different levels of compensation and levy dependent on risk.

The current guarantee under the Financial Services Compensation Scheme and the guarantees that will be in place through implementing the EC Deposit Guarantee Scheme should be applied to each brand rather than each license, and to each depositor. Consumers identify with brands and clear information about the application of the scheme needs to be provided in branches on web sites and on all promotional material.

[28] As above, 22

Crisis management

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

We support enhancing OIVOP and suggest a regular review process where supervisory perspectives, other bodies and consumers can provide input or register objections. The reviews would help to provide early warnings of risk as well as enhancing consumer protection by making a firm answerable for their ongoing conduct and practices, by placing conditions on licence or subjecting a firm to more intensive monitoring.

In other jurisdictions, such as Australia, the licensing system is used to ensure and enforce standards and individual jurisdictions have been prepared to withdraw licences for unfair treatment of customers.

HFC Financial Services, Credit Licensing Authority, Victoria, Australia, 12 September 1989, unreported.
The Consumer Credit Legal Service (on behalf of 57 clients) objected to the renewal of licence for HFC Financial Services. HFC were denied a licence on the basis that they could not be trusted to operate honestly, fairly or efficiently. Grossly improper practices included:

- Methods of collecting repayments
- Requirements of compulsory insurance (particularly PPI)
- Failure to refund insurance rebates after loans had expired
- Failure to inform prospective borrowers of the extent of their repayments
- Conscious failure to train staff

Paul Latimer, Australian Business Law, 28th Edition, CCH, 2009.

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

Written by Linda Weatherhead, Consumer Focus

www.consumerfocus.org.uk

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Council of Mortgage Lenders

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

Response by the Council of Mortgage Lenders to HM Treasury's consultation paper

Introduction

1. The CML is the representative trade body for the first charge residential mortgage lending industry, which includes banks, building societies and specialist lenders. Our 111 members currently hold around 94% of the assets of the UK mortgage market. In addition to lending for home-ownership, the CML members have also lent over £138 billion for buy-to-let mortgages to support a private rental market, and over £60 billion UK-wide for new-build, repair and improvement to social housing.

2. We are pleased to respond to the Treasury's consultation on financial regulation. The general principle of a 'twin peaks' model appears sensible and, if implemented in a considered way and with appropriate safeguards, would provide a robust framework for financial regulation. However, we do have concerns over some of the underlying detail proposed by the Treasury. Although there is a case for change, we do not believe that reform should be reactionary, without sufficient oversight and to the detriment of the market – risks we see in the current approach.

3. Given that the proposals are not home finance specific, the CML will not be responding to each of the detailed questions raised. The CML has seen the responses of the BBA and CBI, and we wish to support the general views they have raised.

'Twin peaks' approach

4. We can see positives in the high level structural changes that are proposed. The separation of prudential and conduct of business regulation has the potential to draw each into sharper focus and give recognition to their different effects. But, the changes in regulatory structure and the proposed objectives of the PRA and CPMA also pose new risks.

5. If the new structure is to work as intended, there must be effective planning and constructive dialogue between the prudential and conduct of business regulators, as well as overarching accountability and oversight. Past cooperation between existing regulators (the FSA and Office of Fair Trading in the case of secured lending) has had a chequered history.

6. There are strong interrelations between the two strands of prudential and conduct of business regulation. Throughout the FSA's mortgage market review, we have expressed concern over the unintended impacts of layered prudential and conduct of business regulation.

7. The MMR, which is primarily focussed on conduct of business, does have implications for prudential regulation, and requires a coordinated regulatory overview and public policy position. Tougher regulation of new business can have implications for back book loans, for example if it leads to significant house price falls, as the FSA has suggested, exposing lenders to unintended prudential risks as the value of the assets against which they have lent in the past falls.

8. We do not believe that the potential or realised impact of prudential reform in the mortgage market, and the staggered changes in Handbook rules, have been assessed in totality by the FSA as part of its MMR. Without appropriate statutory safeguards, we fear that this dislocation could be exacerbated by a physical, organisational and cultural disconnect between the new regulatory bodies.

9. So, the mortgage market already provides a case study of how regulation could end up in the future with the wrong, layered interventions accentuating a regulatory swing to being risk averse in a less benign economic environment.

10. We are encouraged that the PRA and CPMA will "consult each other on rules which they think may be relevant to the activities of the other" and "the CPMA will be required to consult the PRA

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in advance of taking any decision that could cause a firm-specific financial stability risk". However, we would prefer to see these two elements strengthened, so as not to rely on CPMA employees' individual interpretation of what could be relevant to the PRA and vice versa.

11. We would also recommend that the PRA and CPMA are obliged to liaise closely in the development of cost benefit analyses, to give full regard to each other's work.

12. Finally, we are also concerned about the potential supervisory overlap between the two organisations. Lenders are subject to both conduct of business and prudential supervision. There needs to be co-ordination between the two organisations to ensure firms are not overly burdened by potentially conflicting requirements.

The role of the CPMA as a 'consumer champion'

13. We are concerned about how the CPMA will be expected to 'protect market integrity' while serving as a consumer 'champion'. We do not believe that it is the role of an independent regulator to 'champion' any of the parties, it serves as it signals preferential treatment to the detriment of others. There are many other existing organisations far better placed to champion the interests of consumers.

14. In outlining the relationship between CPMA and the Financial Ombudsman Service (FOS), the Treasury argues that the FOS should not be part of a consumer champion because "its claim to impartiality, and hence its legitimacy in making rulings which are binding on firms, is only credible if it does not favour, or appear to favour, consumers". The implication is that the CPMA will favour, or appear to favour, consumers in its work.

15. There is a risk that a 'consumer champion' will not merely act upon market practices that cause consumers genuine, evidence based detriment, but also latch on to populist campaigns, driving up the risk of consumers being exposed to unscrupulous claims management companies. For example, the valid regulatory concern that arrears charges need to be properly levied, against the minority of mortgage borrowers who miss their mortgage payments, may lead to regulatory costs rising for the generality of firms (and therefore customers) due to the FSA's approach in the MMR.

16. The term 'consumer champion', even if its importance is downplayed or placed alongside other objectives, is likely to be the media perception of the CPMA. We would urge Treasury to drop its use of this term and recognise a regulator, particularly one regulating both consumer protection and the markets, should not take a narrow view of its role.

17. We would prefer to see the CPMA help support a marketplace in which consumers are provided with clear product information from which they can make informed choices. This would not only support the existing regulatory obligations on firms, but also ensure that consumers themselves retain responsibility in their decision making – a key weakness in the FSA proposals on responsible lending in the MMR, where 'championing' consumers has been interpreted as protecting them from themselves.

Objectives of the PRA and CPMA

18. We broadly agree with the primary objectives of both the PRA and CPMA. But, in setting a primary objective for each, the Treasury has effectively downgraded other important responsibilities. The 'have regards', such as "the importance of [the PRA] using its resources in the most efficient and economic way" and "principles of good regulation", appear to be essential to the effective operation of any regulator. Failure to recognise their importance would risk jeopardising attainment of the primary objective of both the PRA and CPMA.

19. The importance of principles of good regulation needs particular underlining at a time when the current regulator is undertaking a more intrusive and intensive approach to supervision. We support the FSA's intention in this regard, provided that firms have sufficient regulatory certainty (in the drafting of the rules) and the tools and approaches are deployed proportionately. We would prefer that the principles of good regulation are given greater prominence in the statutory obligations of both the PRA and CPMA.

20. Similarly, the consultation paper appears to understate the importance of the CPMA's second level of 'have regards' in a highly detrimental way. It is very concerning that Treasury is considering whether some of these existing commitments should be dispensed with, such as "the principle that a burden which is imposed on a person should be proportionate to the benefits which are expected to result from the imposition of the burden" and "the importance of [the CPMA] using its resources in the most efficient and economic way". A proven case for new regulation, and cost effective approaches to implementation of regulation, should be a bedrock of any new structure.

21. We believe that it is wrong to suggest that, as a result of the financial crisis of 2007, it may not be appropriate for the CPMA to continue the FSA's obligation to facilitate innovation. This would appear to be a reactionary measure based purely on the circumstances of the crisis and the regulatory environment of the time. It does not give due regard to the importance of innovation and what it can deliver, e.g., diverse business models that serve the market and consumers.

22. Both regulators must enable innovation to flourish in a responsible and sustainable way. Certain non-deposit taking business models, for example, offer prudential level protection to the banking system by meeting demand for higher risk lending and thereby ensuring that it is not concentrated on the balance sheets of deposit takers. At a conduct of business level, the FSA's recent shift towards scrutinising front-end product/service development should provide the appropriate regulatory safeguards to counterbalance a necessary obligation to facilitate innovation.

23. It may be purely semantics, but we would welcome increased prominence and statutory footing of the aforementioned 'have regards' within the obligations of both the PRA and CPMA. As currently drafted, there would appear to be too great a provision to allow these to be superseded, and diluted, by the primary objective.

Rule-making and FSMA safeguards

24. FSMA currently comprises a number of important safeguards to enable rules to be drafted, implemented and monitored in a consultative, considered manner. We are concerned that Treasury is proposing a bifurcation of these safeguards for the CPMA and PRA; particularly given our call for greater coordination between the two regulators.

25. We note and support that existing approaches to consultation will be retained for the CPMA. It is alarming, therefore, that Treasury is considering whether the PRA's rule-making function should be subject to the current statutory processes, such as cost benefit analyses, public consultation and discussion with the Practitioner Panel. We believe that consultation with the public, industry and the current Panels should not only be retained for both regulators, but strengthened.

26. The roles of both the Consumer Panel and the Practitioner Panel are key safeguards afforded by FSMA. Treasury suggests keeping both panels for the CPMA and introducing a statutory footing for the Small Business Practitioner Panel. We support this. It is, therefore, concerning that Treasury is considering whether to retain these Panels for the PRA. Prudential regulation needs statutory consideration by both practitioners and consumers.

27. We would prefer the existing Panels to not only continue contributing to the development of both prudential and conduct of business regulation, but to provide oversight and help identify areas between the two regulators that require greater coordination due to shortfalls in liaison and process (as will no doubt be the practical reality in the future).

28. If you have any comments or queries on this response, please contact Nick Wood nick.wood@cml.org.uk

18 October 2010

This responses is non confidential and given by **Create Solutions Ltd**

Consultation questions
The Bank of England and Financial Policy Committee (FPC)
1 Should the FPC have a single, clear, unconstrained objective relating to financial stability and its macro-prudential role, or should its objective be supplemented with secondary factors?

Yes it should have a very clear and unconstrained objective. if it is unconstrained, it is not necessary for supplementary objectives.

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

As above - not necessary

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

Should be in FSMA

Prudential regulation authority (PRA)
4 The Government welcomes respondents' views on:
- whether the PRA should have regard to the primary objectives of the CPMA and FPC;

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

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

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

No, they should all go. They have added little in practice

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

I agree with the proposed model

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

Yes

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

No

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

N/A

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

Consumer protection and markets authority (CPMA)

10 The Government welcomes respondents' views on:

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

Yes

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

All the principles have had little real effect and should go, especially the cost benefit analysis which is a waste of money and always ends up agreeing with what the FSA want to happen

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

No.

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

The CPMA should distinguish its approach between General Insurance which seeks only to act as a risk transfer mechanism and as such operates in the public interest, and only produces go from that of wealth and investment, which operates on different principles and is greed based and has more in common with gambling.
General Insurance needs less regulation. Its participants are more honest and less bonus driven.

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

Yes

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

The General insurance Industry needs representation perhaps by BIBA or CII

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

No view

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

End the cross subsidy

Markets and infrastructure

15 The Government welcomes views on the proposed division of responsibilities for markets and infrastructure regulation.
No Comment

16 The Government welcomes views on the possible rationalisation of the FSMA regimes for regulating exchanges, trading platforms and clearing houses.
No Comment

17 The Government would welcome views on whether the UKLA should be merged with the FRC, as a first step towards creating a companies regulator under BIS.
No Comment

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

Those regulated by the MoJ - Claims Management Companies

Crisis management

19 Do you have any overall comments on the arrangements for crisis management?
No Comment

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

No Comment

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

No Comment

HM Treasury

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

A Response by Credit Action

Background

Credit Action is a national money education charity (registered Charity in England & Wales No. 1106941) established in 1994.

In January 2009 we also created our dedicated Welsh arm, Credit Action Cymru.

We offer a range of resources, tools and training to help everybody handle their money well, and to inform consumers so that they can make informed decisions about their personal finances.

Credit Action operates at a national level through advocacy, collaboration and partnerships with various groups and companies as well as at a local level through a variety of targeted projects, with a particular emphasis on those most vulnerable to financial difficulties and over-indebtedness. Through its work Credit Action reaches over 650,000 UK citizens every year.

We try and help as many people as possible avoid the pain of debt. However we recognise many contacting us will be in trouble already, so we work in partnership with the major debt counselling charity the Consumer Credit Counselling Service (Registered Charity No. 1016630).

Opening Comments

Credit Action welcomes the opportunity to respond to the Treasury's consultation on the reform of financial regulation in the UK. We believe that it is in the interests of people throughout the country for the UK to have a stable and intelligently regulated economy, and recognise the Government's commitment to achieving this.

Credit Action believes that it is of paramount importance to ensure that consumers are not only protected, but also that they have the knowledge and capability to make informed choices about money and engage constructively with the financial services industry. In our opinion, this is absolutely central to creating the conditions for economic stability now and in the future. Events of the past few years, both at home and abroad, have demonstrated the enormous damage that can be done if consumers take on unsustainable levels of personal debt.

As an organisation committed to helping consumers make informed financial decisions, and to addressing both issues of consumer detriment and financial exclusion, our primary concern in responding to this consultation is with proposals for the Consumer Protection and Markets Authority (CPMA). We view the presence of a strong authority concerned specifically with consumer issues and capable of dealing effectively with problems as they develop as fundamental to the success of any regulatory framework. Ensuring that the prospective CPMA is in touch with consumers on the ground, is able to respond quickly to issues of consumer detriment as they are identified, and stands on an equal footing with the Financial Policy Committee (FPC) and Prudential Regulation Authority (PRA) within the Bank of England, is crucial for us. These considerations form the basis of our answers to the following questions set out in the consultation document.

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

We recognise the tremendous importance of the FPC's prospective macro-prudential role, and that this will be critical to protecting the economy at large from the dangers posed by systematic risk. In times of extreme crisis, we completely understand that it may be essential for the FPC to make quick decisions without having to consult in detail with other bodies such as the CPMA. The importance of a primary objective which the FPC will be able to fall-back on in such circumstances is therefore clear.

However, we believe that there may well be value in requiring the FPC to consider some secondary objectives when making medium- or long-term decisions during periods of relative calm. Requiring the FPC to reflect on the impact of its decisions more widely on consumers may well facilitate better decision-making and ensure that policy-making is more coherent.

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

We believe that the principle outlined in Paragraph 2.28 of the consultation that 'the FPC should, where appropriate, be required to have regard to the statutory objectives of these regulatory authorities [the PRA and CPMA] in order to ensure consistency' is an important model. From the perspective of consumers, ensuring that some consideration is given to the issues they will face as the result of a particular macro-prudential decision is likely to help ensure that markets work in their interests as far as possible.

By way of an example, the issue of counter-cyclical capital requirements has been raised with us as one area in which macro-prudential decisions could have a tangible impact on consumers. The level at which such requirements are set will inevitably have an effect on the amount banks are capable of lending, and therefore on the overall amount of credit available in the market. Ensuring that due regard is given to the impact a particular level of capital requirement will have on consumers would, in our opinion, be positive. Requiring the FPC to take account of the CPMA's statutory objectives as part of its secondary concerns would seem to be a mechanism for achieving this.

We believe that it will be vital to the success of the regulatory process that, in normal conditions, the FPC, PRA and CPMA act in concert as far as possible. We would be concerned if a situation developed whereby the FPC took decisions unilaterally, or the FPC and PRA bilaterally. Measures which ensure that, wherever possible, policy-making serves the interests of all three authorities are therefore welcome.

We would like to reiterate that, where there is a genuine issue of system risk, we think it is absolutely reasonable for the FPC's primary objective to take precedence. The interests of consumers will always be served, first and foremost, by a properly functioning economy. However, where there is space within the decision-making process for the interests of consumers to be given due consideration, we would like to see this take place.

Question 4: **The Government welcomes respondents' views on whether: the PRA should have regard to the primary objectives of the CPMA and the FPC.**

As with the previous question, we believe that it is in the best interests of consumers, good regulation, and the economy as a whole for all three regulatory authorities to work in as coherent and multilateral a manner as possible.

We therefore support the idea that the PRA should have regard to the objectives of both the CPMA and the FPC as part of its own secondary objectives.

<u>Question 10:</u> The Government welcomes respondents' views on: whether there are any additional broader public interest concerns to which the CPMA should have regard.

As noted in our opening remarks, we believe that ensuring that consumers have the knowledge and capability to make informed choices about money and engage constructively with the financial services industry is essential to building a stable economy. We therefore think that there is a strong case for requiring due attention to be given to financial education and financial inclusion issues as part of the CPMA's secondary objectives.

Effective consumer regulation should encourage banks and other financial institutions to support consumers in making informed and sustainable decisions about their personal finances. Therefore, we believe that it is highly important that, as the main consumer protection regulator, the CPMA should actively consider the role it can play in facilitating this. We of course recognise that there are inherent limits as to how far the CPMA, as a regulator, can go in actually providing something like financial education. We are fully aware of the close working relationship that the CPMA will have with the Consumer Financial Education Body (CFEB) with respect to this, and indeed believe it desirable that the objectives of the CPMA and CFEB should not overlap in order to avoid potential duplication. However, we do believe that the CPMA and CFEB both have important, albeit different, roles to play in educating consumers and supporting their decision-making.

With respect to the CPMA, this might for instance involve regulating to ensure that financial service providers give clear and honest statements about the terms of their loans, including a prominent display of APR – this is something that Credit Action has advocated for a long time, and is a principle which we believe could also be applied to overdrafts as well as loans. We note that in Paragraph 4.12 a secondary objective is proposed which reads 'promoting public understanding of the financial system'. We would suggest expanding this to read 'promoting public understanding of the financial system and supporting consumers in making informed financial decisions'.

We also believe that it is highly desirable that the CPMA should be required to consider how it can contribute to combating financial exclusion. It is crucial to recognise that those who are marginalised, excluded or on low incomes are particularly at risk if they suffer detriment. They will probably be less able to navigate the system, and are therefore less likely to be aware of how to seek redress or to know about compensation schemes. Ensuring that the interests of these particularly vulnerable groups are fully considered by the CPMA is essential. We therefore strongly endorse the inclusion of a secondary objective pertaining specifically to financial inclusion. We view the proposed objective outlined in Paragraph 4.12 to be a good model for this, but suggest that this might be amended to emphasise the importance of supporting especially vulnerable groups, and therefore read 'promoting financial inclusion where possible, by encouraging access to suitable products, services and where necessary means of redress, particularly amongst the most vulnerable consumers'.

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

We see transparency and accountability as essential to the success of a body such as the CPMA, and view the accountability mechanisms outlined in Paragraph 4.36 as important steps in achieving this. However, we believe that accountability should be about more than just formal processes – it should also be seen as an opportunity to engage with wider stakeholders, and create a two way dialogue with consumers, third sector organisations and other interested parties.

In our opinion, ensuring that the CPMA is connected to consumers and consumer organisations on the ground, such as Credit Action, will be highly important to the CPMA's effectiveness as a consumer protection regulator. This will enable the CPMA to quickly identify issues of consumer detriment as they develop, and therefore respond effectively when problems emerge. The implementation of mechanisms and structures which promote this sort of dialogue is something that we would strongly welcome. Despite the considerable importance of the relationship between the CPMA and CFEB, we would stress that CFEB alone should not be relied as the only point of connection between the CPMA and consumers – measures which facilitate direct engagement are, for us, vital.

There are some additional points that we would make around this issue. During 2009 proposals were advanced by the previous Labour administration regarding the creation of a Consumer Advocate, a high-profile figure who would co-ordinate work to educate consumers and be champion for groups of consumers who had suffered detriment. We were broadly supportive of this, but in the consultation issued on the proposal in December 2009 argued that for the idea to have resonance with the general public the Consumer Advocate would need to be recognised public figures with a background in consumer campaigning (Martin Lewis of MoneySavingExpert.com is one obvious example, while Credit Action President Keith Tondeur OBE potentially falls into this category as well). We believe that, if correctly managed, the presence of a high-profile Consumer Advocate, acting almost as a conduit between the general public and the consumer protection regulator, could prospectively enhance engagement between both and therefore promote greater accountability. We feel that this concept is perhaps worthy of further exploration.

A further point concerns the quality of communication to the general public on the part of the various agencies involved in consumer protection. We feel that in the past consumers have become confused by the presence of multiple agencies working in this field, such as the Office of Fair Trading (OFT) and Financial Services Authority (FSA), and that this has left them unsure of exactly which body looks after their rights in a given area. This can only be detrimental to accountability. We would therefore emphasise the importance of better communication with the general public on the part of the CPMA and the bodies that it works with such as CFEB, to ensure that the spheres of responsibility of each are well articulated and the public are clear about which body they should approach to help them deal with a particular issue. We would hope that the proposed changes to the regulatory framework do not ultimately lead to a system that is equally or more complex than its predecessor, as this will not be in the interests of consumers.

Further Comments

In addition to our responses to the above questions, we would like to make some brief further comments on issues not specifically addressed in the questions set in the consultation. These concern the proposals set out in the consultation regarding the make-up of the CPMA board and the integration of the FSA and OFT's consumer credit functions into the CPMA.

We would strongly endorse the proposal outlined in Paragraph 4.49 that the CEO of CFEB should sit on the CPMA's board. Having a strong voice for financial education at the highest levels of the CPMA would, in our opinion, be very positive, particularly if supplemented by secondary objectives that also encourage focus on this issue (as outlined in our response to Question 10).

Furthermore, we have noted that in its 2009/10 Annual Report, the Financial Services Consumer Panel praised the recruitment of Mick McAteer and Brian Pomeroy to the FSA board as non-executive directors, and emphasised the benefits of having members with extensive experience of championing consumers and protecting the vulnerable.[1] We would hope that, as part of the recruitment process to its board, the CPMA will also recognise the value of having members of this sort of stature and expertise, and will seek wherever possible to have at least one non-executive director with significant consumer credentials.

We also support the points made in Paragraph 4.55, and agree with the view put forward that the division of consumer credit regulation across the FSA and OFT can lead to confusion and potentially sub-optimal outcomes for both industry and consumers. While we recognise that the OFT's recently announced merger with the Competition Commission may lead to a delegation of its responsibilities anyway, we would endorse the suggestion that bringing the consumer credit functions which have previously been divided between the FSA and OFT together within the CPMA would lead to a simpler and more integrated regulatory regime for consumers. We will respond to any specific consultations on this issue as they arise, but believe that unifying consumer credit regulation under the CPMA is ultimately highly desirable.

Summary of Recommendations

Set out below is a brief summary of the recommendations that we have made in our response:

- The FPC and PRA should both be required to have regard to the objectives of the CPMA as part of their own secondary objectives.
- The CPMA's secondary objectives should include statements which deal with financial education and financial inclusion. We have suggested the following: (i) 'promoting public understanding of the financial system and supporting consumers in making informed financial decisions'; (ii) 'promoting financial inclusion where possible, by encouraging access

[1] Financial Services Consumer Panel, Annual Report 2009/10, p. 12

to suitable products, services and where necessary means of redress, particularly amongst the most vulnerable consumers'.

- The CPMA should see its accountability responsibilities as an opportunity to engage directly with consumers and consumer organisations. We would like to see measures which facilitate this. We also believe the role of a high-profile Consumer Advocate is worth exploring, and that clear communication between the CPMA and the general public is essential.

- We strongly endorse the proposal that the CEO of CFEB sits on the CPMA board, and also believe that this should include at least one non-executive director with strong consumer credentials.

- We believe that it is highly desirable for consumer credit functions which have previously been divided across the FSA and OFT to be unified under the CPMA.

Dear Treasury

I did rather "tongue in cheek" respond to you in a previous e-mail.
However it does appear too late for firms like mine to influence the making of decisions
once they have been taken. Your e-mail suggests that the FSA will continue to operate exactly as it did under the Labour Government but with a different title.

My firm will still be subject to its "broad brush" approach which patently should not happen. I would love to try to influence the outcome of your reformation of the FSA but I feel it is too late.

Over regulation has prevented the expansion of my firm. It has stopped me from

taking on new employees in particular young employees. The more time and cost incurred

in meeting regulatory dictats means that my hopes of supporting the expansion of

UK Industry is hampered.

A G Curtis

A G Curtis t/as John Drew

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

Consultation response from Elizabeth Daly

I am responding to this consultation in a personal capacity.

I have comments on Q5 and Q22. If you accept the analysis in this response, many of the remaining questions become trivial or redundant.

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

Response: The model proposed in paragraph 3.16 is not appropriate – it is a dog's breakfast – and an integrated approach is therefore preferable.

The rationale suggested for splitting the FSA into two bodies is that each will be properly "focussed" (sic). But the reality will be otherwise, as is made clear in Box 3.4 [implications added in square brackets]:

"… putting [the proposals] into practice will require a significant degree of cooperation and coordination by the authorities to ensure that they avoid duplicating efforts, or cutting across each other's work."

" … the need for such coordination will be particularly acute where action taken by one authority directly or indirectly interacts with the objectives of the other."

"… the legal framework will [need to] ensure that the authorities will have each other's interests in mind when making regulatory or supervisory decisions or considering new policy."

" … cross-membership of boards will [be necessary in order to] form the basis of ongoing information exchange between the bodies."

"… [it will be necessary to] ensure that each authority [and their boards] is well briefed on the current key issues facing the other, as well as significant pieces of work or forthcoming rule-making initiatives."

" … The CEO of the PRA will [need to] sit ex-officio on the CPMA board, and vice versa."

"… MOUs … will [need to] set out in detail the mechanics of day to day cooperation and working together, as well as coordination on more strategic long-term thinking."

"… cooperation and coordination will [need to] be operationalised in the MOU through formal college-style mechanisms to support close joint working on the supervision of firms where both the CPMA and PRA have a supervisory interest."

" … where groups containing entities prudentially supervised both by CPMA and PRA, it will be important for the PRA to have confidence that activities elsewhere in the group do not impact on the safety and soundness of the entities it supervises."

"… the PRA and CPMA will, as a matter of course, [need to] consult each other on rules which they think may be relevant to the activities of the other."

"… the CPMA will be required to consult the PRA in advance of taking any decision that could cause a firm-specific financial stability risk, and to take the PRA's advice in such matters. The PRA's decision will [need to] be final,"

“ … these measures will [need to] be facilitated and complemented by legal provision for information gateways between the PRA and CPMA to allow the flow of supervisory information where necessary.”

“… both authorities, furthermore, will be statutorily required to consult the FPC, in advance of any other consultative processes (such as with panels or the public), where either believes there is a risk that the rule it proposes could have material adverse financial stability consequences.”

The model proposed will create two overlapping bodies, with overlapping objectives and responsibilities eg for the FSCS, overlapping board membership, overlapping CEOs, overlapping rule-making powers, overlapping licensing functions, overlapping supervisory functions, and overlapping enforcement powers, for overlapping activities undertaken by overlapping firms. PRA and CPMA will not be properly focused regulators. They will be at each others’ throats.

The previous regime was flawed because of agency capture, exercised both directly by the banks and indirectly through the medium (“hands off the City”) of politicians (Labour and Conservative), journalists, the Treasury and the Bank of England. The two new bodies will be even more susceptible than the FSA was to agency capture, through the additional medium of “divide and rule”.

If the Government really wants to break up the FSA, and protect the regulatory framework from agency capture, it needs to create a stand-alone consumer enforcement body, untroubled by “relationship” considerations with the industry. Giving both bodies supervisory functions by contrast will lead to massive duplication of costs and leave the system just as vulnerable to further regulatory failure if not more.

Q22: The Government welcomes comments from respondents on the assumptions made about transitional and ongoing costs for all types of firm.

Response: the preliminary impact assessment assumes that “there will be no significant additional ongoing costs for the Treasury, Bank of England, CPMA and PRA overall after the reforms have been implemented”. Given the answers to Q5 above, this is clearly nonsense, and the costs will all be borne by firms, as well as by consumers if the Government’s proposed dysfunctional arrangements are implemented.

I note that no benefits have been identified to justify splitting the FSA into separate supervisory bodies:

“There are a number of variants in the proceed option based on different allocations of particular FSA functions or regulated firms between the PRA and CPMA, or other bodies. These are not considered further at this stage. It is impossible quantify the benefits of the proceed option in a realistic way.”

The overall benefits of the proposed reforms are stated to be “reducing the frequency or severity of financial crises” and it is claimed that these will “outweigh the additional resource costs.”

However, the benefits will flow from the decision to give the Bank of England, through the FPC, oversight of microprudential regulation, whereas the costs are attributable to the decision to break up the FSA and turn into two overlapping supervisory bodies. In other words, the benefits can be achieved without the costs. The proposal to break up the FSA is misconceived, unjustified, and completely unnecessary in order to satisfy the coalition agreement. It is an expensive and potentially dangerous distraction.

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

Dart Compliance Limited is a compliance consultancy dealing mainly with small insurance intermediaries and IFAs. In consultation with its service members we have issued this response to the recent HM Treasury consultation on the forthcoming regulatory regime.

In view of the limited scope of our clients' activities in relation to this consultation, we have only answered questions relevant to our clients' interests, as indicated below.

James P Dart **Cert PFS**
Managing Director
dart COMPLIANCE LIMITED
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Consultation Questions

10 The Government welcomes respondents' views on:

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

10.1 It seems only sensible and prudent that all regulatory bodies operating the UK Financial Services regime should, at least, have regard to the ongoing stability of firms and the financial system as a whole, if only to prevent increased cost of reviewing conflicting rules.

10.2 The existing principles for good regulation (other than the desirability of facilitating innovation and global competitiveness of the UK financial services industry, as already suggested at 4.11) would appear to still be appropriate.

10.3 As stated above, we would agree that these aims may not be compatible with a regulator whose primary objective is ensuring consumer confidence in financial services, and on protecting consumers and ensuring market integrity. However, it is also fair to say that maintaining the competitiveness of the UK Financial Services sector is a vital role and should, therefore be performed at a higher level, by the FPC, particularly as this ongoing competitiveness would be likely to have an effect on, both, the financial and prudential position of Providers, as well as future stability of the system itself.

10.4 Promoting public understanding of the financial system, and informing consumers on products and services available within it are laudable aims for a consumer protection regulator, however great care must be taken to ensure that the information issued by the regulator (and CFEB) on a generic basis is balanced against the possibilities that specifically identified individual needs may exist which could appear to be at odds with that generic information.

We are concerned that the remit of the CPMA in regulating the conduct of financial institutions and Insurers in addition to intermediaries may be too broad a remit and result in inadequate supervision of these larger firms, as has been the case under the existing regulator.

11 Are the accountability mechanisms proposed for the CPMA appropriate and sufficient for its role as an independent conduct regulator? 12 The Government welcomes views on the role and membership of the three proposed statutory panels for the CPMA.

11 We believe that the mechanisms appear appropriate and sufficient

12 We believe that continuing the three statutory panels is desirable, however the 'Smaller Businesses Practitioner Panel' can still appear to be somewhat remote and disconnected to the majority of small intermediaries and it may be that there is an increased role for membership bodies, who may have a closer relationship with regulated micro-enterprises, to play a part.

We also believe that representation on the panels giving an informed **external** perspective of Insurer's claims behaviours and settlement practices, which are effectively the 'shop window' of the industry and play a huge part in consumer confidence, should be sought as part of, both, the Consumer Panel and Smaller Businesses Practitioner Panel', for example, from the Institute of Public Loss Assessors or one of its regulated members who have daily experience in insurer behavioural trends.

Section 7 - Implementation.

Bearing in mind the existing resourcing issues being experienced by the FSA (eg. Staffing levels and workload management), the impact of 7.9 and 7.10 are of great concern. Existing delays in handling new applications for authorisation and VOP applications, as well as Approved Person changes are currently increasing, with the latest figures showing an increase in 'targets missed by more than 10%' (Source: FSA Service Standards Graph Oct 09 – Mar 10) and, with what I believe is a further deterioration since these were published, I am concerned that proposals to move staff into the 'shadow structure' will leave the FSA with insufficient resources to provide anything resembling acceptable service levels.

Dear sir/madam,

Please find below a response on behalf of DAS Group UK to the consultation paper 'A New Approach to Financial Regulation':

A number of questions within the consultation relate to the objectives of the proposed regulatory bodies, both in terms of the form these objectives should take and the level of regard each body should have to the objectives of the other bodies (questions 1-4 & 10). For firms which will be subject to these regulations, the form these objectives will take is less important than their content and clarity. It is important that the FPC, PRA and CPMA each have regard to the objectives of the other bodies, ensuring inconsistent or contradictory standards or requirements are avoided, so that financial services firms, particularly those subject to regulation by both the PRA and the CPMA, have a clear understanding of the expectations of each body.

For all firms that will be subject to dual regulation from the PRA and the CPMA, the clear concern is that sufficient coordination between the two authorities will take place to ensure firms are not subjected to unnecessary duplication of reporting requirements or contradictory rules. Further guidance at an early stage on how such issues would be resolved would be helpful for firms, including a route for resolving any contradictions or duplication identified.

Much has already been written on how insurers were not subject to the same failings as the banking sector (in particular, the June 2010 report by the CEA, 'Insurance: a unique sector'). If the insurance sector is to be regulated by the PRA, the regulations applicable to this sector need to recognise the far lower level of risk it represents in comparison to the banking and investment sectors and should avoid taking a 'one size fits all' approach. Regulations covering insurance firms should be proportionate and reflect the different risk profile, systemic relevance and role in the economy that insurance firms represent, compared with other sectors falling within the remit of the PRA.

In response to question 7, it is considered that safeguards are required for the PRA's rule making function. Appropriate consultation and cost benefit analysis provide financial services firms and other interested parties with an essential opportunity to voice any concerns regarding the proportionality and practicality of proposed rule changes, allowing potential issues to be identified and resolved at the draft stage. Publishing final rules without these safeguards would create a risk that the rules adopted may be disproportionate or misunderstood by affected firms, which in turn may require the PRA to either amend the rules or issue further clarification or guidance.

Proposing the potential removal of current safeguards around rule-making for the PRA introduces a potential lack of consistency compared to the approach to rule making to be adopted by the CPMA, which will be subject to a number of important statutory processes including wide consultation and both market failure analysis and cost-benefit analysis prior to the introduction of any new rules. It is proposed that such safeguards should also be adopted in respect of the rule making powers of the PRA.

In response to question 13, the adoption of the CPMA as the levy collecting body for all regulatory and associated bodies would seem to be a sensible approach and should reduce the regulatory burden on firms subject to regulation by both the CPMA and the PRA.

Reference is made to the CPMA collecting fees for the new CFEB but there is little information at present regarding how the CFEB would be funded, i.e. will this be fully or partially industry funded, how will firms' contributions be calculated etc. Further information on the proposals for funding this body would be helpful for firms in assessing the overall cost of implementing these proposals.

Impact Assessment comments

The transitional costs for all firms affected by these proposals (whether they will be regulated by just the CPMA or also by the PRA) would appear to be understated in this paper. All firms will need to review all company and product literature, marketing material etc making reference to the FSA. They will need to amend these to reflect their new regulatory status and ensure these are used with immediate effect once the new regulatory regime commences. The cost of carrying out such a review, coupled with the costs generated by the replacement of all literature could be significant for firms.

Similarly, even if the rules set out by the CPMA and PRA differ little from those currently set out in the FSA handbook, firms will need to carry out a thorough review of all aspects of their business to ensure they remain compliant with the new requirements. This could again require a significant investment by firms, particularly those who will be regulated by both the CPMA and the PRA. As such, provision of final rules for each new regulatory body as far in advance of their implementation date as possible would assist firms to effectively manage the transition from the current regulatory regime.

Finally, when assessing the transitional costs for firms, consideration should also be given to the cost of staff training and awareness regarding the changes to the current regulatory regime. This will affect all financial services firms but firms subject to dual regulation from the CPMA and the PRA are likely to need to provide more in depth training to explain the different roles of the two bodies.

Kind regards,

Ian Stone
Senior Compliance Officer

Sent by email on 18 October 2010 to financial.reform@hmtreasury.gsi.gov.uk and separately in mail to Financial Regulation Strategy, HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

HM TREASURY: A NEW APPROACH TO FINANCIAL REGULATION – judgment, focus and stability

Dear Sir/Madam,

I am writing on behalf of Deloitte LLP in response to your request for comments on this paper and welcome the chance to contribute to the debate on these important questions.

As you will see, we have summarised what we believe are the key issues in an introductory section to our response.

Russell Collins
Financial Services Industry
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General comments

We welcome the open and constructive way in which the Government has begun the consultation process, and applaud its intention to continue this approach in the future, while accepting this must not cause undue delay or uncertainty.

In that spirit we have addressed a number of questions that are not explicitly listed in Annex A, but which we nevertheless believe to be important.

Transition

As the paper recognises, there are considerable risks in any transition process. In this particular case the impact could be serious, given the need to agree and implement a wide range of changes to regulatory policy, carry out high-quality operational supervision, operate effectively in international fora, and avoid imposing unnecessary costs on business. We are pleased to see the emphasis in the paper on these issues, but the success or otherwise of the project will depend on how well they are tackled in practice. In particular, we note the very considerable personnel and systems issues involved in splitting the FSA[1] into two or more units and in integrating the arrangements of the PRA[2] with those of the Bank of England; and the need to consider how best to "grandfather" existing authorisations and permissions.

Governance

We have questions about the proposed governance of each of the new bodies – the PRA, CPMA[3] and FPC[4].

The PRA will be a subsidiary of the Bank of England, with a board chaired by the Governor, and will implement the macro-prudential decisions of the FPC. But in all other respects the paper states that the PRA will have operational independence for the day-to-day regulation and supervision of firms, with a majority of non-executives on its board and with the Bank having no formal power of direction over it. It remains to be seen how this will work in practice: we have some concerns that this arrangement may, initially at least, contain some unhelpful ambiguities.

Within the CPMA, the Government proposes an operationally distinct and strong markets division to lead on all market conduct regulation. We very much agree that there is a need for such a distinction to be made, to ensure that the regime applied to wholesale business is proportionate and effective. However, we are concerned that this separate identity is not buttressed by any independent directors or corporate structure, so it is as yet uncertain how it will operate.

Finally, it is unclear whether the FPC will be a "Committee of Court" – ie with non-executive membership entirely comprising those already on the board of the Bank of England – or whether it will follow the same model as the Monetary Policy Committee, where the independent members do not serve on the main board. We see some merits in this latter model, which will allow a wider selection of candidates with relevant experience to be considered.

[1] Financial Services Authority
[2] Prudential Regulation Authority
[3] Consumer Protection and Markets Authority
[4] Financial Policy Committee

Objectives of each agency

The paper describes the CPMA as a "strong consumer champion" although it notes that the Financial Ombudsman Scheme will only be credible if it does not favour, or appear to favour, consumers. Given its powers to act against firms, the CPMA too needs to show that its rules and actions are balanced and proportionate. Whether this can easily be done as "consumer champion" remains to be seen.

Relations with others

It will be important for the CPMA and PRA to work together so that firms do not face clashes in terms of data requirements, meeting requests, supervisory demands and so on. In other words, effective relationship management with the industry will be important to the success of the new structure. The paper contains few details on how this might work. Although we understand it may be premature to spell out all of these ahead of agreement on the key objectives and roles of each body, it might help allay concerns if rather more information on this could be shared relatively early in the consultation process.

Proportionality

This is an important principle, which lies behind concepts such as cost/benefit analysis, considerations of UK competitiveness and – importantly - the need to ensure that "one size does not fit all" (as opposed to the demand for "a level playing field"). It could helpfully be embedded more fully into the new arrangements.

Consultation questions

The Bank of England and Financial Policy Committee (FPC)

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

In general we favour unambiguous objectives for a policy-setting body, since that clarity helps provide accountability, which is necessary for the arrangements to operate effectively.

For instance the Monetary Policy Committee is required to deliver price stability, defined as the Government's 2% target for consumer price inflation, and subject to that to support the Government's objectives including those for growth and employment. As such one objective has clear priority: nevertheless, if all else is equal other factors can be taken into account.

Financial stability, however, is rather different. It has no clear measure, equivalent to the 2% inflation figure. In the absence of a specific definition of how much financial stability is appropriate, it will remain a more subjective aim than the price stability goal. Moreover, it is typically set as an absolute goal (ie by not defining a threshold for unacceptable instability it implies the more stability the better) rather than as a symmetrical target around which undershoots are taken as seriously as overshoots.

Against this background, in order to introduce balance into the arrangements, the FPC needs to take some account of secondary factors. As a society we want a financial system that is not only stable, but is also efficient, affordable, and responsive to the changing needs of users ("innovative"). To the extent that financial stability is not in conflict with these aims there is little harm in including them as secondary factors. To the extent that they are in conflict, some account needs to be taken of them. If this cannot be done through the choice of target measure (equivalent to 2% inflation) it needs to be included in the factors that the FPC takes into account, with some indication of the relative weights to be applied to each.

In addition, until the macro-prudential tools that the Committee will deploy have been identified in more detail and implemented to some extent, it will be difficult to decide whether its objectives are realistic or not, and what the appropriate checks and balances on its activities should be.

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

It is essential that the UK financial system is not only stable, but also competitive (both internally and externally); efficient; responsive to changes in technology and tastes; and trusted to deliver appropriate services to customers.

Some of these outputs will arguably be delivered by other bodies, such as the (separate) competition authorities or the CPMA, whereas some (such as international competitiveness) will result from the delivery of other objectives, such as efficiency, responsiveness and stability.

Achieving more financial stability depends not only on improving the resilience of the financial system but also improving its flexibility to respond to changes or external shocks. Designing measures to improve financial stability will need to factor in the full costs or potential counterfactuals from alternative measures. If an event such as Long Term Capital occurs, a system which protects financial stability in that situation might need to exhibit different characteristics from one resilient to other events, such as a fall in domestic house prices.

We note that paragraph 2.45 of the paper states that the Treasury representative should "ensure that the Government's economic priorities are taken into account". Such language could be misinterpreted as affecting the independence of the Committee: to the extent that these priorities are relevant they would be better captured by being included in the factors considered by the Committee.

We believe that the FPC needs to ensure that measures designed to make the system financially stable (or more stable) – its primary objective – should wherever possible minimise the negative impacts on efficiency and responsiveness to change. Its actions should also not needlessly cut across the goals of the competition authorities or the CPMA, and have proper regard to the principle of proportionality. They may also need to take into account the UK's international obligations or undertakings in the regulatory policy areas.

None of this should be allowed to put the fundamentals of financial stability at risk. Instead it should help determine the choice of tool to meet a particular financial stability goal, and have a wider influence at the margin to ensure that a balanced approach is adopted.

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

To the extent it is possible to provide a definition and measure of financial stability that has some element of symmetry within it (ie to recognise it is possible to have too stable, or perhaps too rigid, a system, in the same way as too low a rate of inflation) then the "have regards to" formulation appears best: ie a list of factors that should be taken into account only insofar as the primary objective is not put at risk. If that is not possible (as set out under question 1) then it may be necessary to set out a list of secondary objectives, with an indication of the relative weights to be applied to each, despite the potential loss of clarity that might result.

Once these policy decisions have been taken, there is also a practical question as to which precise formulation best delivers the desired result in legal terms.

Prudential regulation authority (PRA)

4 The Government welcomes respondents' views on:

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

Paragraph 3.6 states that if objectives conflict, the “have regards” formulation means that the PRA will be required to defer to its primary objective. This is a helpful clarification. As such we agree it should “have regard” to the objectives of the CPMA.

Since the FPC can give directions to the PRA on the use of macro-prudential tools, and recommend actions to it where it believes specific actions are required, it is less clear that the “have regards” formulation is necessary in this case, but we agree it should be included in the legislation as we can see no disadvantages from doing so.

The “principles for good regulation” include a variety of factors. One relates to the way firms themselves are regulated (role of management) but many other factors that are equally important in this respect are not included. One (the efficiency and economy of the regulator) would in most other public bodies be delivered by other accountability mechanisms. There is one intermediate objective (improving public awareness) for which a separate consumer financial education body has now been established. It would be sensible to reconsider how far these principles need still to be enshrined in legislation.

It is important, however, that the PRA’s actions remain proportionate, that supervisory actions reflect the international character of the UK market, that competition is not unnecessarily restricted and that the financial system is responsive to the changing needs of users (“innovative”). None of these principles should be used to over-ride the PRA’s primary objective. But other things being equal, all of them are desirable.

To some, language relating to the competitive position of the UK and to “facilitating innovation” is seen as inappropriate for a prudential regulator. Nevertheless, we believe that the international character of the UK market, and the adaptability of its financial system, are highly relevant, and need to be taken into account by policymakers and included in the legislation. If expressions such as maintaining UK competitiveness and facilitating innovation are considered inappropriate we would be happy to offer some drafting to capture these points using alternative language if that were helpful.

We note proposals for a wider “public interest” test – eg to analyse the economic impact of the PRA’s policies or the effects on lending. Such a test might be better employed at the level of the FPC – though the benefits of applying it to either body would need to be assessed against the potential uncertainty it might cause.

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

We consider that the model proposed is the only workable model formally: if one individual was approved by the PRA, and then found to break crucial CPMA rules, it would result in confusion over the arrangements and hence a lack of accountability.

But in practice there needs to be intensive co-operation between the two bodies, even if neither can formally delegate their responsibilities in this field. It will be important for them to work together so that firms do not face clashes in terms of data requirements, meeting requests, supervisory demands and so on. In other words, effective relationship management with the industry will be important to the success of the new structure. If not, the burden on firms and individuals will be excessive, with no benefit to show for this bureaucracy.

Although we understand it may be premature to spell out all the details of how collaboration might work ahead of agreement on the key objectives and roles of each body, it might help allay concerns if rather more information on this could be shared relatively early in the consultation process.

There is also considerable potential for collaboration on support services (eg a shared services capacity) which may help reduce the costs otherwise implied by these changes.

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

We support risk based approaches to supervision and this inevitably requires judgement, although we note that rule based approaches require some too. Most regulatory policy is set at the global level (eg Basel) or via European Directives or Regulations. Whilst the UK is influential in both, if others take a different view the UK cannot by itself prevent a rules-based approach, particularly in the light of the push towards a single EU rule-book. Unfortunately, detailed rules typically offer less scope for judgment on policy matters.

While regulatory policy is not the same as operational supervision, it can act as a significant constraint on the ability to deliver a judgment-focussed approach. So the approach outlined here may not be sufficient to deliver the hoped-for results.

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

We consider that they are – particularly in assessing whether any new proposal is proportionate or not. These disciplines are of greatest importance at the EU level: if in practice there is little discretion at national level over the means of implementation, local cost/benefit analysis is of less use. Otherwise it is of great importance, though it needs to be carried out in a way that is robust and open to scrutiny.

The consultation process is crucial, not least to inform the FSA in international debates. Done well it can be of mutual benefit: it is unreasonable to expect policymakers to evaluate every possible implication of their proposals without external assistance.

Similarly, it is essential that the PRA has access to expert independent input into its decisions. The "Grey Panther" model can provide expertise, but not so much independence (and eventually the market insights may atrophy). We consider that the Practitioner Panel - on which Deloitte serves - has played an important part in providing such independent input and so could perform a role in respect of the PRA in addition to the CPMA.

If it is nevertheless felt that this is an inappropriate model for a body that will not be dealing with conduct-of-business issues, we suggest that something along the lines of the Board of Banking Supervision is used, to provide independent advice to PRA management on the external realities it faces, the cost-effectiveness of the remedies it is pursuing, and on individual cases (in the last case a role that the practitioner panel cannot play). If such a body is established, it is essential that it has figures that are very knowledgeable about insurance and other non-banking activities.

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

See previous answers.

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

The proposal states that the PRA will have operational independence for the day-to-day regulation and supervision of firms, even though it will be a subsidiary of the Bank of England and chaired by the Governor. It remains to be seen how this will work in practice: we have some concerns that this arrangement may, initially at least, contain some unhelpful ambiguities. These are heightened by remarks such as those in paragraph 2.13 that "the intimate relationship between macro-prudential regulation, micro-prudential regulation and supervision, and the provision of liquidity insurance to banks means that there are clear advantages and synergies in having these functions being carried out within the same organisation – namely the central bank".

As indicated earlier, we support the creation of a Board of Financial Services Supervision, similar to the old Board of Banking Supervision. It is for consideration whether this should be on a statutory basis, or as proposed left to the discretion of the board of the PRA, though on balance we would prefer such a group to have legislative backing.

Consumer protection and markets authority (CPMA)

10 The Government welcomes respondents' views on:

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

See our answer to Question 4. In our view it is even more important for the CPMA, when considering equally effective means of delivering its aims, to choose ones that minimise the impact on competition, and the capacity of the financial system to adapt. These measures also need to be proportional, and reflect the international nature of the market. They also need to be subject to rigorous cost-benefit analysis.

When discussing the words "have regards to" in the context of the PRA, the paper notes that this formulation means that the PRA will be required to defer to its primary objective (para 3.6). In para 4.7, however it states only that it would "generally" expect this to be the case for the CPMA. This ambiguity and inconsistency is not helpful. If on occasion other factors should take priority at the CPMA (and this might be the case if the solution to the issue raises costs or reduces consumer choice disproportionately) then different language should be used in the legislation that governs it.

In addition, in box 3.B it states that where a CPMA decision could cause firm-specific financial stability risk, then the PRA decision would be final. Whatever the merits or otherwise of this arrangement, this too suggests that in this particular case, the "have regards to" wording is not the right formulation to use.

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

As noted earlier, the paper describes the CPMA as a "strong consumer champion" (para 4.3) although it notes that the Financial Ombudsman Scheme will only be credible if it does not favour, or appear to favour, consumers (para 4.44). Given its powers to act against firms, the CPMA too needs to show that its rules and actions are balanced and proportionate. Whether this can easily be done as "consumer champion" is far from clear.

We note – and welcome – the fact that the CPMA will be subject to the duty to carry out detailed market failure and cost/benefit analysis (para 4.20).

We are not persuaded that the requirement to hold an annual general meeting brings many benefits in practice, although the costs associated with it are also limited.

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

We support these proposals. However, we suggest that more thought is given as to how the Practitioner Panel can best represent the interests of both "retail" and "wholesale" elements, which might help to underpin the independence of the markets section of the CPMA: see following section.

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

We see the case for this proposal.

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

This is a complex issue, which is not dependent on the structure of financial regulation in the UK. As such it should be the subject of a separate consultation.

Markets and infrastructure

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

Our more fundamental concern, which is not the subject of a consultation question, is that while the Government proposes an operationally distinct and strong markets division within the CPMA to lead on all market conduct regulation, this separate identity is not buttressed by any independent corporate structure. Since we believe that the appropriate regime for wholesale and retail conduct of business regulation is very different, we would like the arrangements to be underpinned in this way. Otherwise there is a real risk that retail-style regulation will be extended to wholesale markets. This issue has been a continual theme since the establishment of the Securities and Investments Board in 1986 and the carve-out of certain wholesale markets from its remit, which were instead given to the Bank of England.

We see the case for supervision of the systemic elements of the infrastructure (such as settlement systems and central counterparty clearing houses) to move either to the Bank or the PRA (after all, many systemically important firms will be supervised by the

PRA) but note that this complicates the supervision of exchanges that own in-house CCPs.

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

We have not responded to this question.

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

The paper does not at present make a convincing case for change in this area, to set against the possible disruption in the transitional period as responsibility for primary and secondary markets is separated out.

In addition, we note that other EU countries have not yet adopted such a model. As such in discussions at ESMA the primary markets will in general be directly represented by their regulator, which would not be the case in the UK if this proposal goes ahead: such an arrangement brings with it some risks.

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

We have not responded to this question.

Crisis management

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

The last few years have shown how important it is to ensure clarity about responsibility for the various types of decision that might be taken, to enable rapid and effective decision-taking, and to understand the international ramifications of the issue. Understanding what overseas authorities will in fact do in a crisis – to protect their own stakeholders and in response to domestic laws and political pressures – is essential for these purposes.

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

The actions listed are worth considering further but we would caution against mandatory triggers for some forms of intervention – in some cases this might not be in customers' best interests (eg if capital ratios dipped below a trigger when the next day there was a very high probability of recapitalisation).

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

To the extent that there are real conflicts between the role of lead resolution authority and prudential regulator (which we rather doubt) these are unlikely to be solved if the individuals managing these two functions both report to the Governor of the Bank of England.

Impact assessment

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

Since we are not one of those firms identified, we have not responded to this question.

Depositary
And
Trustee
Association

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

18 October 2010

Dear Sirs,

HM Treasury Consultation: A new approach to financial regulation

The Depositary and Trustee Association (DATA) represents all depositaries and trustees of UK based authorised funds. At the end of August 2010, the members of DATA were responsible for safeguarding £516 billion of fund assets. DATA welcomes the opportunity to comment on the proposals outlined in the above mentioned paper.

Whatever the outcome (i.e. single or joint supervision) there should be clear roles and responsibilities. All lines of communication should be clear. Those responsible (whether PRA, CPMA etc.) should be required to liaise and co-operate with each other to ensure that there are no gaps in supervision, to avoid significant problems within the UK regulatory framework.

There should be clarity and efficiency of regulatory reporting and, for example, payment of fees. Ideally reporting should be through a single portal which can then be directed seamlessly to the appropriate bodies. Similarly, as highlighted by the Investment Management Association, fees should be collected by a single body.

It is essential that the different types of authorised collective investment scheme, Open Ended Investment Companies (OEICs) and authorised unit trusts, continue to be regulated in the same way. In DATA's view, there can be no justification for separating the two in terms of regulation. OEIC regulation was originally included in a separate code (rather than under company law) because they are very different from companies within the Companies Act. The spectrum of investors into OEICs and unit trusts is broadly the same and the key stakeholders in the industry (i.e. the FSA, depositaries and authorised fund managers) have systematically worked together over the last 10 years to align the two vehicle types in operational structure and investment eligibility.

The regulatory structure needs to recognise that most of the policy issues that affect our industry originate in Europe. It follows that the structure should not impede the ability of the UK to frame and influence EU policy initiatives. As noted in the IMA response some Directives only permit one competent authority. Similarly only one UK representative can sit at ESMA. The introduction of another regulator will impact many of the initiatives in UCITS IV e.g. cross border mergers, master feeders and notification etc.

Paragraph 1.7 states "Effective prudential regulation of firms requires an approach based on understanding of their business models, and the ability to make judgements about the risks that firms' activities pose to themselves and to the wider financial system as a whole." Our belief is that the risks posed by the activities of a depositary are not materially different from the operators of collective investment schemes with whom we share our Part IV permission.

Yours sincerely

David Morrison
DATA Chairman

Dear Sirs,

Please can you clarify what will be happening to the proposed changes that the FSA are currently discussing and consulting on? For example, there was talk of regulating the Buy-to-Let mortgage sector. There was also a proposal to regulate secured loans/second charges and have that removed from the OFT. At the consultation stage is the approved persons changes.

What will happen to all of these and (many) more with the disbanding of the FSA?

Is the regulatory scope going to change?

Businesses cannot continue with this uncertainty around the detail. Mr Vince Cable MP is calling for more lending but banks are not going to be innovative if they are unsure what regulator is going to be in place and whether product regulation is going to be implemented.

Yours Faithfully

Rob Derry
Managing Director
Brunel Mortgages and Loans
w: www.brunelmortgages.co.uk

Dear Sir or Madam,

I have been noting further articles from good quality professional firms like Ernst & Young on the negative and damaging impact of the retail distribution review. I really do feel that someone at the Treasury needs to curb the FSA on this proposal before it goes any further. It has become abundantly clear that the FSA are trying to force this through to avoid loss of face, however the industry does not need it. The FSA need to be stopped by someone with some business acumen and common sense.

The RDR is going to be massively damaging. Many good IFA's are now moving back to banks to prepare for this. Many other good IFA's with independent businesses will be forced to shut them down, including me. I am a fully qualified CF30 adviser and will be a pensions specialist by December. Very few people have this level of pensions examination.

If the RDR is allowed to move ahead it's likely our business will suffer so much it won't be able to operate.

The FSA have been destroying the IFA industry for years now and the proposed RDR is going to remove financial advice from the reaches of normal people on middle incomes.

In our business we have done numerous pieces of corporate pension business this year and I can promise you that every member of each pension we have dealt with has benefitted greatly from the advice we provide. Had these firms been unable to fund us via commission paid from the group pension product there is no way they would have agreed to proceed with the advice process on a fee basis. It is also unlikely that the members could afford that level of advice via an initial deduction of a fee from their plan.

I agree with having a minimum standard for qualifications, however I am becoming increasingly vehement about the fact that the RDR's proposed commission ban will actually reduce the availability of advice. Financial practices have been squeezed harder and harder for years, as cost bases increase due to massive levels of totally inefficient regulation from the FSA. As such the volumes of business IFA's execute decline and the time spent in front of clients becomes less readily available. These factors ensure that advice becomes more costly and less available. IFA businesses have to employ more staff to cover the over-regulation and consumers still don't get protection from the FSA when it counts.

Please stop this proposal from being introduced. Stop the ban on commission. It will damage the industry unquestionably. I can appreciate the reasons for it, but clients don't want to pay a fee for financial advice. It simply won't work. IFA firms will fold, less tax will be paid and jobs will be lost. The availability of independent advice will be massively reduced.

Regards,

Keith
Keith Dickson
Director
d2 Financial Solutions