House of Commons

Treasury Committee

Financial Conduct Authority

Twenty-sixth Report of Session 2010–12

Volume II

Additional written evidence

Ordered by the House of Commons to be published 10 January 2012

Published on 13 January 2012
by authority of the House of Commons
London: The Stationery Office Limited

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List of additional written evidence

Written evidence

Written evidence submitted by the British Retail Consortium

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

Context—The Significance of Credit for BRC Members

The BRC has been fully engaged in the debate on the future of financial regulation in the UK. It has responded to the joint HMT and BIS consultations; "A new approach to financial regulation"; "Building a stronger system"; "A blueprint for reform" and the FSA consultation "The Financial Conduct Authority—approach to regulation".

This response develops the issues already raised by the BRC in these responses.

Those BRC members who provide financial services expect to only be subject to regulation by the FCA, and do not expect to fall within the ambit of the PRA.

We have briefly described below the different ways in which BRC members are impacted by consumer credit and financial services in their business models. These include:

— Lenders—retailers who themselves or through separate companies in their group provide credit to their own customers.

— Credit intermediaries—retailers who have arrangements with a bank or finance house which provides their customers with point of sale retail credit, either through fixed sum loans or running account credit.

— Acceptance of credit cards issued by third parties.

There are a number of variants on the second of these models, including storecards, branded credit cards and instalment credit, offered through a variety of affinity and joint venture relationships between banks/finance houses and retailers.

Some BRC members are currently authorised and regulated by the FSA as insurance intermediaries, as well as being licensed by the OFT. Others are not regulated by the FSA.

The availability of accessible and convenient sources of credit is critical to the retail sector. Its importance lies primarily in the retail demand generated via access to credit, and goes far beyond the income or profit generated by the credit products themselves. Any action which restricts access to or convenience of credit will also impact retail demand, and slow consumer spending. There are therefore direct implications for UK economic growth.

Additionally, widespread availability of convenient and secure payment mechanisms is absolutely critical to the continued development of the e-commerce marketplace, particularly for online and mobile transacting.

By way of illustration of the importance of consumer credit to the retail sector:

— Credit and charge cards were used to make two billion purchases in the UK to a value of £139 billion in 2009.

— Amongst retailers with their own lending operations, such as the home shopping companies, it is not untypical for more than 90% of sales to be made using their own credit facilities, with most of the balance using third party credit cards.

Specific Points for Submissions

1. *Are the objectives of the FCA clear and appropriate?*

1.1 Subject to the points made at 2 below, BRC members broadly support the overriding strategic objective and the three operational objectives, together with the new duty to promote competition unless incompatible with its strategic or operational objectives. If consumer credit comes within the remit of the FCA, BRC members believe that the objective of promoting efficiency and choice in the market will be particularly relevant to the consumer credit sector.

2. *Should the FCA have a primary duty to promote competition? How should this work in practice?*

2.2 In the light of the FSA's paper on the proposed approach of the FCA, BRC members believe that in practice the relatively subtle distinction between the FCA having a primary objective to promote competition or having a duty to discharge its general functions in a way which promotes competition (unless incompatible with its operational and strategic objectives), is less important than the view of the FCA of the scope of its competition remit, and the demarcation lines between it and the new Competition and Markets Authority. BRC members are concerned at the first indications from the FSA on how it views this remit. In particular, in the FSA's paper on its initial thinking on the FCA's approach to regulation, the FSA appears to be construing this remit as an argument for becoming a price regulator, making judgements about the value for money of products and considering the exercise of "its powers to take action where costs or charges are excessive". (Chapter 3. Box 2).

2.3 It appears to BRC members that, whilst the FSA claims to acknowledge that "the FCA will not be an economic regulator in the sense of prescribing returns for financial products or services", this is exactly what it envisages doing. If the FCA determines what is or is not an unfair or excessive charge for financial products, it is effectively setting a benchmark as to what it does regard as a fair or acceptable level of charge. BRC members fail to understand the distinction between this, and acting as an economic regulator.

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

3. *Does the FCA's approach to regulation, as outlined in the FSA's June 2011 document, represent an improvement on that of the FSA?*

3.1 BRC members have a major concern that the thought processes driving the design and approach of the FCA are centred on the existing FSA, and the products and markets currently regulated by the FSA. However, if the Government's preferred option for future regulation of consumer credit is adopted, the majority of FSA regulated firms will be consumer credit providers. The FSA will be regulating a huge and diverse sector which may not have been considered when its structure and operating principles are formulated.

3.2 In particular, it appears to be a working assumption that the FCA will regulate approximately 27,000 firms. This assumes that the vast majority of existing consumer credit licence holders will not be regulated by the FCA. This therefore assumes that either:

- Regulation of consumer credit will not move to the FCA; or
- The number of consumer credit licence holders will be reduced by circa 80/90%, so that very few firms not currently regulated by the FSA will fall under the FCA. This can only be achieved by taking most consumer credit licence holders outside the scope of regulation, or by introducing an appointed representative style regime for credit. However the viability of this model is doubtful given the reluctance of lenders to accept the degree of risk and cost this would entail.

3.3 Accordingly, there appears to be a very real risk that the FCA will be designed to regulate a market similar to the existing FSA regulated market, but will actually find itself regulating a much bigger and more diverse market. This creates an obvious risk that it was not designed for its full eventual purpose.

3.4 Any consideration of the approach to regulation of the FCA should take as a working assumption the Government's stated preferred option that consumer credit will be within the scope of the FCA's remit, at least until the Government has concluded its consideration of the issue towards the end of 2011. This response is based on this assumption.

3.5 The FCA must be designed to allow a proportionate approach to regulation, particularly consumer credit. This must reflect the different risk dynamics of the credit market as opposed to the investment and insurance markets, and particularly the economics and cost efficiencies of the retail credit market, where loan or credit limit values are usually in the hundreds of pounds, not the thousands.

4. *To whom should the FCA be accountable? Are the lines of accountability clear?*

4.1 BRC members welcome the increased accountability to HM Treasury now proposed. It is a major concern of BRC members that, because of the criticality of the unsecured consumer credit market to consumer spending and therefore to the health of the retail economy as a whole, the actions and policies of the FCA (assuming it becomes the regulator for unsecured consumer credit) will have major economic implications for the UK. It is therefore imperative that the FCA has clear and direct accountability to Government and its activities are closely scrutinized by Government. The role and effectiveness of the non-executives appointed by Treasury and jointly by Treasury and BIS will ultimately be critical in achieving this accountability, particularly the extent to which they engage through Treasury and BIS with business and consumer groups to keep close to market sentiments and developments.

5. *Are the powers of the FCA suitable? Will they be subject to appropriate scrutiny? How should the FCA be interacting with industry as well as using its intervention powers?*

5.1 Over the last ten years retail credit providers have enjoyed a positive and progressive relationship with Government and regulators, such as BIS and the OFT. Trade bodies, such as the BRC, have also enjoyed an open and productive relationship. Whilst we welcome the proposed details of FCA Board membership and panels, there is concern that important cultural relations, built up over a number of years, will diminish—

ultimately at the expense of effective market functioning and regulatory oversight. BRC members appreciate and acknowledge the proposed role of Treasury in making key FCA appointments, however members remain concerned that the distinct nature of the unsecured retail credit market, and the regulatory oversight this requires, may be subjugate to wider Government policy on more mainstream financial regulation. The hope is that those chosen to manage the FCA are sufficiently well placed to account for and acknowledge key difference in the markets they intend to regulate.

5.2 The need for both close and constructive dialogue with industry and accountability to Treasury and BIS is even greater given the potentially far reaching economic impacts of the proposed greater emphasis on product intervention. If applied to consumer credit markets, the economic impacts could include:

— Price or interest rate controls, which would inevitably remove access to regulated credit from certain sections of the community.
— Prescriptive or intrusive "responsible lending" criteria, which would also extend financial exclusion.
— Limiting access to point of sale credit, which would have a major impact on retail sales and the consumer economy.
— Increased regulatory burdens and compliance costs, which will prove unsustainable for many firms (especially smaller firms), reducing the number of providers and weakening competition.
— Reduced innovation in the market place. Regulation of products by hindsight, under the "product intervention" proposals, will create unacceptable degrees of risk for lenders. It seems likely that this will result in a reduction of innovation in the market place, and a market with fewer players, all offering similar products, with little competition or innovation.

5.3 Any actions which restrict access to, or availability of, retail credit will inevitably have a correlating effect on retail sales, on retailers, and on the UK retail and consumer economy.

5.4 BRC members have concerns as to how the product intervention principles, which are a key element of the proposed new "toolkit" for the FCA, would apply in the retail consumer credit market, particularly when dealing with smaller firms who would be unlikely to be directly supervised on a relationship managed basis. The FSA have indicated that they expect that fewer firms will be relationship managed under the new regime, and this does not take into account the likely transfer of consumer credit firms to the FCA. BRC members are concerned that the mechanisms for product intervention are being designed along principles based on regulation of the major banks and insurers, with no consideration of the practical implications for the consumer credit market, which will largely be comprised of smaller, contact centre managed firms, of which the FCA will inevitably have less day to day visibility. The risk that any action by the FCA against such firms will be retrospective rather than anticipatory is higher, and therefore the extent of uncertainty for such firms when they bring new products to market will be greater.

5.5 The proposals on product intervention to declare products void, or issue warnings, have major implications for individual businesses and sectors. In particular:

— Any public statement from the FCA that it has concerns about a product, or that a product has, in its opinion been mis-sold or is unenforceable, will trigger an immediate reaction amongst claims management companies (CMCs). As CMCs have the threat of referring any claim that isn't settled to FOS, with a non refundable £500 fee being automatically payable by the lender regardless of outcome, retail credit providers (with typically balances below £500) would be in a very vulnerable position, unable to defend claims cost effectively.
— The threat of unenforceability may also impact the ability of lenders to obtain funding under securitizations or other funding structures based on the receivables as security. If a wholesale funder believes there is any risk of systemic unenforceability or uncollectability they are unlikely to be willing to provide the funding.
— Any public indication that the FCA has concerns about a particular product or firm will inevitably cause its funders to consider whether to withdraw funding. Initial concerns voiced by the FCA are therefore likely to have catastrophic consequences for smaller firms, who don't have the balance sheet strength or resources of the major banks or insurers. It is therefore critical that any public action can only be taken when the process for establishing the threat presented by the product has been fully completed, rather than allowing any concerns to be publicised prematurely. If they prove to be unfounded or exaggerated the damage to the firm will already have been done.
— Unenforceability of whole portfolios in the credit market would have a knock on effect into the wholesale markets, as the wholesale funders themselves are hit by the loss of their wholesale loans.
— Unenforceability of substantial portfolios will also lead to business collapse, with consequential job losses and economic consequences, affecting both the retail credit provider, and the retailer who depends on the funder for retail sales.

5.6 These risks are exacerbated by the proposals on early publication of warnings. The damage to companies will inevitably occur at publication stage, and if the warning is subsequently found to have been unwarranted or exaggerated it is unlikely that the damage will be reversible.

5.7 Similar risks exist in relation to the reputational damage for firms (particularly smaller firms) if action on financial promotions is taken prematurely.

5.8 Given the wide ranging powers of the FCA, it is essential that appropriate independent checks and balances be provided to enable a firm to challenge FCA decisions and actions quickly and cost effectively. It has been in no one's interest that when the FSA is perceived to be acting beyond its powers, or irrationally or unfairly, the only recourse for firms is a judicial review, as with the BBA application in connection with PPI. An internal appeals process to an independent judicial body is essential, particularly given the even more extensive powers and sanctions being proposed. The BRC welcomes the principle of greater transparency and openness which is proposed, but this is not in itself a substitute for effective independent appeals processes within the FCA.

6. *Break up of the FSA. Coordination and Information sharing with PRA.*

6.1 BRC members' key concern is that, assuming responsibility for credit regulation moves to the FCA, it has sufficient experienced staff who understand the unsecured consumer credit market. There are staff with such knowledge in both the OFT and BIS, and it is critical that such knowledge is preserved within the FCA, and is sufficiently influential. One of BRC members' biggest fears is that credit is transferred to FCA, who then immediately commence a rewrite of consumer credit legislation with insufficient understanding or experience of a market which is not only extremely diverse and complex on its own, but is also very different to the other markets currently regulated by the FSA. Many regulatory principles and assumptions derived from current FSA regulated markets are not equally applicable to the unsecured consumer credit market.

7. *Interaction with Other domestic regulators*

7.1 The relationship with the new CMA is commented on above. With regard to FOS, BRC members believe that great care must be taken to ensure that its role as an independent dispute resolution service is not compromised. If its dealings with the FCA are not totally transparent and arms length, it will be compromised. BRC members believe that the position of the FOS as an independent judicial body is already blurred—the fact that it is described in the Treasury Select Committee question as another domestic *regulator* reinforces this concern.

8. *Interaction with EU Regulators*

8.1 Consumer credit is subject to a harmonizing EU directive, which greatly constrains the extent of UK discretion. The Consumer Credit Directive will come under review shortly, and other initiatives at EU level are currently underway, for example on APR assumptions. It is critical that the FCA represents UK interests in EU level negotiations, and has experienced staff able to engage effectively with UK businesses in identifying emerging issues, and then presenting arguments at EU level.

October 2011

Written evidence submitted by the Financial Services Practitioner Panel

Introduction

1. The Financial Services Practitioner Panel is the statutory Panel set up under FSMA to represent the interests of practitioners to the FSA. As such, we have a close understanding of policy development at the FSA, and have taken a keen interest in the Government's plans for regulatory reform. The details of the Panel's remit, and its current membership is at Appendix 1.

2. Our latest biennial survey of regulated firms which was published in early 2011, showed that the overwhelming majority of firms across all sectors agreed that strong regulation is for the benefit of the financial services industry as a whole. We are keen to ensure that this regulation is effective both from the point of view of overall confidence in our industry and in terms of costs to the industry in funding the regulators and for compliance within firms.

Treasury Committee Questions

Are the objectives of the Financial Conduct Authority (FCA) clear and appropriate?

3. The objectives of the FCA are reasonably clear and appropriate. However, we are concerned that the proposed broad definition of consumers for the FCA does not make sufficient distinction between retail and professional consumers of financial services. Although we welcome partial assurances that different types of consumers will receive different regulatory protection and treatment, there needs to be a high level commitment that this is the case in practice. It is vital to recognise that retail consumers need much higher levels of protection than professionals, or have access to appropriate regulated advice. Professionals should be allowed to operate on the assumption that they have a much greater understanding of risk and the nature of the products they propose to buy. A failure to ensure such a distinction could have serious implications for innovation and

efficiency in wholesale markets. Too stringent regulation of wholesale and markets risks being counter-productive for consumers as well as firms, as it could inadvertently encourage firms to base their wholesale activities in jurisdictions with less stringent regulation. This would ultimately undermine the interests of the UK economy and consumers.

4. A universal definition of consumer for the FCA is also likely to encourage a tendency towards "one size fits all" approach to regulation. This is something that we have challenged the FSA on, as we believe the financial services industry is too complex for policies to be applied across sectors without serious consideration of their effectiveness in different arenas.

5. We would also like to see the FCA having an additional regard to the competitiveness of the financial services industry as a whole. Our views on this are set out in more detail in answer to the following question.

Should the FCA have a primary duty to promote competition as recommended by the Treasury Select Committee and Independent Commission on Banking? How should this work in practice?

6. We are generally supportive of the proposed competition powers, but do not believe that the FCA should have a primary duty to promote competition. It seems entirely appropriate that the FCA's overall strategic objective is to promote and enhance confidence in the UK financial system. We suggest that, if there is a need for a more implicit recognition of the competition role for the FCA, it could be inserted in to the second operational objective. This would then read as "Promoting efficiency, choice *and competition* in the market for financial services".

7. With regard to the FCA's competition powers as proposed by the Government, we would like to see more detail about the price intervention powers for the FCA before giving our full support to this aspect. For instance, we would like to see strict, set criteria for the FCA taking action on price when there is significant evidence that competition is impaired. The FCA Approach document reads: "The FCA will thus consider exercising its powers to take action where costs or charges are excessive". There are concerns around when and how such judgements would be made, and are keen to see greater detail on how this is proposed to work in practice before giving it our full support.

8. On the other hand, we strongly believe that the FCA should have regard to competitiveness as well as competition. We would like to point out that there is a significant difference between competition and competitiveness—the former looking at the dynamism of the internal UK market, and the latter at the UK's relative competitive position on a global basis. The Panel believes the regulator should have regard to both, particularly as the FCA it will play a significant role in negotiations on behalf of the UK in EU and international fora.

9. We therefore suggest the addition of a "have regard" for UK competitiveness—in addition to that of competition. We believe that, at the very least, there should be an understanding that if the regulators have the choice of two options for action of equal merit, they should select the action which has the least adverse effect on competitiveness. UK firms compete in a global environment, and a lack of regard of regulatory actions on the relative competitive impact of our industry compared to those of competitors situated abroad could have significant long term implications for the presence of the UK and London as a financial centre.

Does the FCA's approach to regulation, as outlined in the Financial Services Authority (FSA)'s June 2011 document, represent an improvement on that of the FSA?

10. The Panel's views on the risks of the adoption of a twin peaks model are considered in response to the subsequent question on the importance of coordination.

Balanced approach

11. For the FCA itself, we would like to be sure that it will take a balanced, proportional and rational approach to regulation. Although much of the FCA Approach document published in June 2011 appears reasonable, the tone of debate at the launch conference seemed to concentrate on criticism of the industry, rather than adopting a more constructive and forward-looking tone. We are hopeful that, as the new FCA Chief Executive-elect started work in September 2011, it will be possible to build constructively on the detail of the role for the FCA as set out in the Approach document.

12. However, there were also some proposals in the June 2011 document which could ultimately undermine rather than enhance confidence in the system. For instance, the FCA Approach document said that the FCA's interventionist stance and lower tolerance for consumer detriment is likely to result in more enforcement cases. We would wholeheartedly support this approach if it targets clear examples of non compliance where there is potential detriment for example, "boiler rooms" and other unregulated financial services activities, including money lenders. However, if this refers to all regulated firms, the FCA is starting out with an extremely pessimistic presumption about the impact of its new approach on its regulated firms. Building on the existing conduct initiatives, for example, around Treating Customers Fairly, should mean that the proposed new product intervention initiatives and a more proactive approach to regulation will result in fewer, not more, enforcement cases. If the FCA interprets its objectives in this way, with a predetermined disposition towards enforcement

across the industry, there is a real danger that the FCA will undermine rather than enhance confidence in the UK financial system.

13. We would like to see Government and political commitment to the idea that the FCA must take a proportionate, balanced and constructive approach, whilst carrying out robust challenge. This is all the more important as the FCA will have a crucial role in the regulation of the wholesale and markets arena, where it will be important for the UK's international reputation that the regulator is seen to have a constructive approach.

Consumer responsibility

14. We were disappointed that there was no detailed discussion of how the FCA will carry forward the principle of consumer responsibility in the June FCA Approach document. This is something which the FSA has not been particularly clear on in the past, and the FCA's new approach provides an opportunity for this aspect to be clarified. We believe that although there must be clear safeguards of protection and information especially for retail consumers, it is key for the FCA to make clear that consumers will be responsible for some aspects of the decisions they make.

Supervisory approach

15. We have not seen evidence to support the plans for the FCA to use business analysts and call centres, in place of much of the direct supervision of firms currently undertaken by the FSA, and we are concerned that this could lead to a net reduction in the effectiveness of regulation. We believe that it could result in lower quality staff and regulation, as the supervisors have less direct contact with firms and less practical knowledge of the industry and its clients. We appreciate that a balance has to be struck between relationship management and costs depending on the size and complexity of firms, but believe that relationship management can be a key component of effective regulation.

16. The Panel would recommend the FSA conduct a cost benefit analysis on the merits of sustaining the current level of relationship managed firms going forward to ensure that the balance is struck at the right level before the final decision on the structure of FCA supervision is made. Our Biennial survey of regulated firms, published in February 2011, showed that firms understand and appreciate the FSA's policies and objectives much better when they have direct contact. We believe that strong and proactive supervision can only be built on supervisors' ongoing knowledge of firms, their people and the sectors in which they operate. We believe that the benefits in terms of effective supervision are greater than the costs. We would advocate stripping back the central resources and theoretical business analysis, in favour of greater quality of direct supervision.

Risk appetite

17. We also believe that the Government should encourage the FCA to set out its risk appetite in public as a key part of its operational model. The Government's June 2011 White Paper stated that the FCA will have a "lower risk threshold for potential consumer detriment". In order to make key decisions on resource allocation and priorities, as well as to assess its own effectiveness over the longer term, the FCA will need to define more closely what type of risk it would be willing to take, and the type of risk that it would find unacceptable. This would provide the FCA with a yardstick with which to measure its own performance, allowing it to refer to its risk appetite in intervening (or choosing not to intervene) in particular cases.

18. Such a public statement of risk appetite would enable the Government, Parliament, and the wider public, to understand the target level of protection being set by the regulator. We note that the PRA has made clear that it will not be a "zero failure" regime. However, this has not been made so explicit for the FCA, and yet there needs to be clear understanding of the level of consumer protection that the FCA is hoping to achieve in the event of any future crises.

To whom should the FCA be accountable? Are the lines of accountability clear?

19. We believe it is right that the FCA is accountable to parliament as proposed. We are pleased to see that the contribution of the independent panels to policy making at the FSA has been recognised and will be enhanced with the addition of statutory Smaller Businesses Practitioner Panel and a new Markets Panel.

20. However, since the Government is designing a "twin peaks" regulatory system, with all the consequential dangers of gaps and overlaps, we believe that the Panels could be all the more effective in the new structure if there was a similar forum for debate with the PRA, and linkages between the Panels for both sides of the regulatory divide. This could be an important contribution by industry participants to coordination and communication between the FCA and the PRA, especially where there is a need for joint initiatives to minimise the costs to firms and to ensure a holistic view is taken. The Government's June 2011 consultation stated: "The Government expects that, over time, the regulators will develop their own regulatory culture and approach to engagement with firms" (2.135). We need to have a means of highlighting the development of any conflicting regulatory requirements and a means of improving the effectiveness of regulation through better coordination with both the PRA and FCA. We have highlighted to the Government, the FSA and the Bank of England, our view that there is currently a gap in the mechanisms for engagement with industry in the lack of a proposal for a Practitioner Panel-type statutory body at the PRA, with clear linkages to the FCA Panels. In our view,

this would be best achieved by requiring a statutory Practitioner Panel to engage with both the FCA and the PRA.

21. It has been stated that the FCA will be more interventionist and more judgement-led in pursuit of better consumer outcomes. This means that it will be just as important to ensure that there are clear accountability mechanisms within the FCA, as well as those externally to Parliament. The Practitioner Panel looks forward to playing its role in providing a key part in providing feedback on behalf of the industry into policy proposals from the FCA going forward.

Are the powers of the FCA suitable? Will their exercise be subject to appropriate scrutiny? How should the FCA be interacting with industry as well as using its intervention powers?

22. We are concerned that the new product intervention power for the FCA is being promoted as the new "magic bullet" answer to improved consumer protection. We acknowledge that it will be useful for the FCA to have tighter powers to control any product that can and does do harm, through greater regulation at source with the product provider. However, the challenges and risks to this approach should not be underestimated. It requires regulators to be able to fully understand the businesses they are regulating, to be able to predict the future contribution of products to consumer utility and to do all of this taking a proportionate approach. In particular, this should not cause the FCA to decide to discard all the investment that the industry has made in previous regulatory initiatives such as Treating Customers Fairly. Often it is not the product which is wrong but the fact that it is sold beyond the target audience for which it was designed. In this regard, the Retail Distribution Review, itself a very substantial change across industry and the regulatory regime, aims at improving the product/customer outcomes and further product intervention would seem inappropriate without first bedding in the investment made in the RDR.

23. These new product intervention powers should be considered as just one of the range of tools which the regulator will have at its disposal in achieving its objectives. Our comments on risk appetite above are also relevant to this subject. We also have concerns around how this power will be used and the liabilities that could arise. The Government needs to clarify the implications for the regulator and firms, should the regulator "approve" a product, or perform a detailed review of a product and not raise any objections, when the product is subsequently proven to be unsafe; equally, this could be problematic if the regulators restrict the use of a product that is subsequently shown to be safe. In cases where either firms or consumers suffer detriment as a result of the regulator's actions, it is unclear what the regulator's liabilities and legal obligations would be.

24. We also continue to be concerned about the Government's proposals for early publication of disciplinary action. We acknowledge that there will not be a duty on the regulator to publish, and the power will be subject to certain safeguards. However, we are nevertheless sceptical of how the safeguards will be operated, and whether all the implications will be considered. It may be that the publication of a warning notice may mislead consumers and result in detriment if they decide to exit a firm's product or service early, when in fact no issues are proved to exist. There is also the possibility of legal hazards for the regulator if the publication of a warning notice has led to losses for consumers, shareholders and staff. One example is the publication in 2010 of the FSA investigation into the activities of Gartmore fund manager Guillame Rambourg. There was a resultant outflow of assets and reduction in the share price of Gartmore, following which it was acquired at a lower price by the rival asset manager Henderson.

25. It will be essential that at the very least, the safeguards on consultation and fairness on the publication of warning notices are complied with fully by the regulators. We would also like to see a commitment to a public review of the use of this power by the regulator, after a number of cases have been publicised.

26. As has been set out in our answer to the previous question, we believe that the Practitioner Panels as proposed for the FCA will provide a valuable forum for interaction with industry at an early stage of policy development and to provide high level debate on areas of concern for the industry and regulator. However, we believe there is a fault line in the consultation proposals, as the Government is not currently proposing any statutory Practitioner Panel for the PRA. We believe the input to the FCA would be more effective if the Practitioner Panel also had a linkage in to look at and advise on the policies of the PRA through a linked Panel or other mechanism.

How will the break-up of the FSA work in practice? Issues of coordination and information sharing between the FCA and the Prudential Regulation Authority (PRA).

27. The Practitioner Panel has taken an ongoing interest in the FSA's plans for splitting into the two new organisations. We have had regular briefings on progress from the FSA and Bank of England teams responsible for the project. We have highlighted our concerns about cost control and the need to ensure that the FSA does not take its eye off the ball during the transition period. Overall, we have been broadly satisfied with the way that the project has been run. Our main area of concern has been with the loss of senior staff from the FSA during the transition period and we have raised this recently with the Chief Executive and Chairman of the FSA. It will be crucial to the success of the FCA that it is able to recruit high calibre and effective people to its senior management positions.

28. As yet, we have not seen the detail of the coordination plans for the FCA and PRA. It is therefore difficult to give detailed feedback at this stage, although we continue to emphasise with the FSA that effective

coordination is essential to the success of the new regulatory model. The question of authorisation has already been addressed by the Government; we would also point to the regulators' assessment of business models, governance and management as areas where coordination will be important.

How should the FCA be interacting with other domestic regulators? For example, the FCA's relationship with the Bank of England and Financial Ombudsman Service

29. As has been stated in answer to previous questions, it will be critical to ensure that there is effective coordination between the FCA and the Bank in relation to the PRA. However, it will also be the case that there needs to be effective coordination with the Bank in relation to its role in overseeing the FPC, and being responsible for the direct regulation of clearing and settlements.

30. We have already highlighted with the Government that there needs to be further clarity on the powers that the FPC will have to direct the activities of firms through the PRA and FCA. It will be vital there is some method of inputting to the FPC in highlighting particular negative effects or unintended consequences of any actions it takes—from the regulators themselves and from those affected by the FPC's directions. We note that the Government has proposed that from the FCA, only the Chief Executive will be a member, compared to more members from the PRA and Bank. This means that the FPC must guard against the FCA's views being sidelined in the FPC debates.

31. There are also some organisations which will be dual regulated by the Bank and the FCA—paragraph 2.33 of the Government's June 2011 consultation states that "institutions which provide both exchange services and central counterparty clearing services will be regulated by the Bank with respect to their activities as RCHs, and separately regulated as RIEs by the FCA." There must be a clear memorandum of understanding between the FCA and Bank of England to cover any conflicts and gaps in regulation. It will also be important to have open dialogue in terms of international representation, as the FCA will hold the UK seat on ESMA, and yet will need to represent the interests of the Bank as well in debates on EU markets policy.

32. We believe that the FCA should have an explicit governance role or oversight mechanism over the Financial Ombudsman Service (FOS), to ensure some broader accountability and coordination between the rules of the regulator and the decisions of the Ombudsman Service, as well as provide some limited ability for appeal against FOS decisions. We appreciate that this would need to be designed to allow the FOS to continue to discharge its responsibilities. However, this should firstly help to address the problem that there has been between the FSA and FOS, when the FOS has made decisions on the basis of perceived "fairness" that can create precedent without necessarily taking account of the FSA rules prevalent at the relevant time. This may also help to address some of the current obstacles to the take up of simplified advice, as firms have asked the FSA to agree a limit to firms' responsibility for advice. However, there is an unresolved concern that FOS may not interpret firms' responsibilities in the same way as the regulator, and so bring wider factors into account, which means that it is difficult to offer simplified advice on a commercially viable basis.

33. We also continue to believe that there should be some alternative appeals process for firms to contest FOS decisions on a limited basis. The FOS costs for firms are significant, and at the moment, it is difficult for firms to have any means of controlling these costs. This is particularly in the light of the increasing number of vexatious claims being encouraged by Claims Management Companies (CMCs). Although the regulation of CMCs is a matter for the Ministry of Justice, we would like to see a new governance mechanism for the FCA which is able to consider appeals against FOS decisions, and could review the impact of the action of CMCs on the operational costs of financial services firms.

34. We would also like to see a clearer role for the FCA in relation to the impact of FSCS levies than the FSA has had until now. We believe that the funding requirements for FSCS even have the potential to cause systemic risks for certain sectors of the industry which are called on to fund significant levies, although we appreciate this will occur under extreme scenarios. The FCA should not keep the arms length approach that the FSA has taken on the impact of FSCS funding on the viability of firms. We are hopeful that, as the PRA will also have a responsibility towards FSCS, they will encourage the FCA also to take an interest in the prudential impact of FSCS levies on the firms which they prudentially regulate.

35. The FSA announced that it is restarting the review of FSCS funding in October, with formal consultation due in the first half of 2012. This review will be significant, and key lessons need to be learned and taken on board from previous regulatory events (including KeyData and PPI) by the new regulators. It will also be important for the review to consider the methods of allocation of firms to each of the compensation pools, with a regular review of this system. The full involvement of industry will be necessary in these decisions, as firms may have to support major funding requirements or not, depending on their pool allocation.

36. We have also become increasingly concerned about the lack of accountability in terms of the funding of the Money Advice Service (MAS) via the FSA and by the FCA in the future. We agree that informed and educated consumers are better consumers and provide better consumer outcomes. However, any initiatives to educate consumers must be created in the context of providing value for money. MAS has been set up as an independent organisation, and yet the FCA will be responsible for collecting a significant levy from the industry to pay for it. (The levy was £43.7 million for 2011–12.) We would like the FCA to have a specific role in ensuring value for money from MAS and as the funding will be from industry, we believe there must be public

discussion of the costs and benefits of the Money Advice Service. We would like the accountability of the MAS to be made much clearer in this new legislation.

How should the FCA be interacting with international regulators? Do EU regulation initiatives restrict or enhance the work of the FCA? Will the FCA be able effectively to engage with the EU supervisory authorities?

37. It is crucial that the FCA builds on the good work that has been undertaken by the FSA in the last few years to improve its relationship with international regulators and to assist the government in ensuring that the UK has a strong voice in the development of international regulation, particularly within the European Union. The new structure in the UK with "twin peaks" split by prudential and conduct, and with the Bank of England directly looking after certain sectors, will not, however, fit neatly into the new European regulatory regime, although it will not be impossible for the UK to find ways to overcome this structural barrier. The Panel regards liaison with Europe as increasingly important, and would encourage regulators to seek to ensure that interaction between UK and EU regulators continues to be a top priority also during and after transition. Our request for a Panel for the PRA is partially driven by our concerns for a mechanism for industry to engage with regulators on international matters in an effective way.

38. We believe that the FCA's role in engaging with the EU and international supervisory authorities will be enhanced if it also has a responsibility to "have regard" to the competitiveness of the UK industry, as outlined above. UK firms compete in a global environment, and a lack of regard of regulatory actions on the relative competitive impact of our industry compared to those of competitors situated abroad could have significant long term implications for the presence of London as a financial centre and the UK as a whole as a centre of excellence for financial services. Indeed, UK financial services firms compete with firms from other countries, including from the EU, in most areas of financial services whether delivered to UK or overseas customers. The different regulatory environments of the firms' home countries are potentially important contributors to the ability of the firms to serve customers and even within the EU there remain variations in the way regulatory initiatives are implemented. We believe that, at the very least, there should be an understanding that if the regulators have the choice of two options for action of equal merit, they should select the action which has the least adverse effect on UK competitiveness. In the context of the Listing Authority, the FSA currently has a responsibility towards competitiveness, but this will be lost in the new proposals, as Listing is subsumed into the overall objectives of the FCA.

October 2011

Written evidence submitted by Justice in Financial Services

Summary

1. What is required is that the House of Commons should re-assert control over the regulators. It is unacceptable that the regulator should simply be able to ignore the House and to tell a Committee that the regulator, not the Commons, has the final decision. A Committee is not just another source of evidence: it is a Committee appointed by the *communitas* of the United Kingdom.

2. A simple solution would be to enable the Commons to repeal any rule made by a regulator by a Resolution passed by the House. As this might be regarded as a step too far, we propose another change.

3. A less radical and in any event necessary change is to enable the Committee (and the House if it so wished) to require an investigation into any matter that it, rather than the regulator or a Minister, decided should be the subject of an Inquiry.

4. To avoid the need to create a large staff (and possibly a US style Financial Services Committee) we suggest amending Section 14 of FSMA to require the Treasury to set up an Inquiry should it receive a letter from the Speaker requesting that it does so.

5. Such an amendment would leave it for the House to determine its own procedure prior to the Speaker sending such a letter. The House has an established mechanism for this, and this would give the House flexibility to alter its procedures if it wished—for instance with a change of role of Committees.

6. The amendment of Section 14 should provide that the Report of an Inquiry is to be made to the House of Commons or to Parliament. The report should explicitly be protected by Article 9.

7. The amendment should also provide for the House to have a veto over persons that the Treasury proposes to appoint and the ability to provide for a timetable.

Importance of the Commons

8. The House of Commons has a near continuous history that goes back to the thirteenth century. Although—no doubt to the considerable relief of Ministers who prefer to keep their persons physically intact—it no longer exercises the powers of a Court in punishing errant royal servants and others, it remains by far the most important forum in which the infringements of rights and mistreatment by government and government bodies

are addressed. Ministers can be made to defend and justify their actions. This does not necessarily require a full debate and resolution—ministers are conscious of the dangers of alienating MPs. They share Iain Macleod's desire to avoid being "tarred and feathered in New Palace Yard".

9. The regulators behave arrogantly because they are not under such immediate pressure. In the fourteenth and fifteenth century a royal servant who treated the Committee with the contempt that has been shown by Hector Sants would suffer death by "drawing, hanging and beheading"—unless the Lords gave permission for simple beheading. (The Merciless Parliament set a clear precedent. The royal servant who was let off with simple beheading was Richard II's steward of the household, Sir John de Beauchamp de Holt, whose effigy is in Worcester Cathedral—the head is attached.)

10. This independence calls into question the legitimacy of the regulators. There is a serious argument (going back to St Isidore, re-stated in Aquinas and developed in the 16th century by Suarez, Bellamine and Parsons) that although statute law can prevent the Courts from interfering in activities of regulators and can allow the establishment of tribunals and other mechanisms for enforcement, it cannot, in our system, confer legitimacy. Legitimacy flows from the consent of the people and in our constitution that consent is always dependent on continuing supervision by the House of Commons. This is a fact of ministerial life—hence the determination of the Rt Hon Harriet Harman MP and her master the Rt Hon Gordon Brown MP to prevent the Commons debating substantive motions; hence the importance of the Backbench Business Committee and its power to enable Members to move substantive motions to the Wright Reforms as implemented by the resolutions introduced and recommended by the Rt Hon Sir George Young MP in 2010—a reform first proposed by Parsons (Memorial C X)—see above. Parsons' starting point was that Parliament, not the Monarch, was the fount of all laws and settled orders in the kingdom. This doctrine makes the power of officials and regulators only legitimate when it has the (at a minimum implicit) approval of Parliament.

11. An important consequence of such a political theory (which is a natural law theory that legitimises positive law enacted by and with the consent of Lords and Commons) is that there is no "moral" obligation to obey any law or ordnance that is not at least implicitly approved except in as far as obeying contributes to obeying the primary precepts of the natural law. We are rightly concerned to maintain and strengthen the legitimacy of our institutions, whether against rioting hoodies or more sinister terrorists. It is, to say the least, unsatisfactory that the regulator for about 1/8th of the economy is not undeniably legitimate.

12. Regulatory independence poses a problem that goes well beyond financial services. The Chair of the Health Committee has discussed the role of his Committee in providing a mechanism whereby health bodies can relate to Parliament without being subject to ministerial control. By making the financial regulators answerable to the Treasury or any other Select Committee the regulators could be given a legitimacy that they currently lack.

A Power to Revoke Rules

13. Proper control over the regulators would logically require that the House should be able by Resolution to revoke a rule made by a regulator.

14. This would only be viable as a last resort power. One would expect and hope that it would only be used if Ministers were solidly behind the regulator and the House took a different view. In such circumstances it would be only one stage short of a vote of no confidence or a major amendment to a Finance Bill.

15. However the presence of such a power would ensure that never again would a regulator be able—as Hector Sants was able—to tell the Committee (or indeed the House) that he, not the elected representatives of the people, had the final say. Still less would he dare to do what he did over the RDR Report. Disraeli would have had no difficulty in describing what he did—Sants pissed on the Committee.

16. If such a power to revoke were granted, one would anticipate that the route would be a substantive motion, either moved by the Opposition, or by a Member of the House in time allocated by the Backbench Business Committee. It is unlikely that the Backbench Business Committee would grant such a motion other than on the recommendation of the Treasury Committee unless there clearly was very widespread discontent across the House.

Amendment of Section 14

17. The greatest obstacle to effective supervision of the regulators is lack of information. One way round this would be to establish a large, qualified staff, capable of carrying out detailed investigations. This would be a major change in our arrangements here.

18. An easy alternative would be to amend S14 of the Financial Services & Markets Act 2000 to provide that the Treasury MUST set up an Inquiry if directed so to do by a letter from the Speaker (or, if it is desired to give the Lords a similar power, the Lord Speaker).

19. The Speaker should be empowered to give a date for a report to be delivered.

20. Either the House should be given a veto over the appointees or the Speaker should be able to direct appointments.

21. The Report should be expressly protected by Article IX of the Bill of Rights, so that it could not be used in legal proceedings. This would remove the obstacle that persons with something to hide can place in the way of publication of a document that could lead to their prosecution. This would not of course prevent any person wishing to bring proceedings from pursuing their own inquiries:

22. Detailed procedures would then be for the House to determine, presumably through the Procedure Committee. The following points might be worth considering:

(a) The Speaker might send such a letter if a Committee (usually the Treasury Committee) made a report recommending such an Inquiry, or if the House passed a Resolution, but not otherwise.

(b) The Treasury might be required to submit its proposed names to carry out the Inquiry which could be challenged by the Committee.

(c) There might be provision for a Report to remain unpublished until a Committee had held its own inquiry if the Speaker were satisfied that allegations against an individual or a company were made that required that the subject of the allegations be allowed to make representations before publication took place.

23. Section 14 might need amendment to ensure that any matter specified by the Speaker (or the Lord Speaker) might be the subject of an Inquiry. At present the Treasury's power is constricted.

Benefit of this Approach

24. S14 Inquiries are not intended to substitute for Committee Inquiries. They are intended to provide the Committee with a factual (and if need be legal) matrix from which it can decide whether to commence and inquiry and when it does so to minimise the time required to get at the facts.

25. One option for the Committee on receipt of a Report would be to hold a one-off evidence session rather than a full Inquiry. If the Report were clear and comprehensive then such a session might enable the Committee (and the Backbench Business Committee if an MP requested a debate) to determine whether there was a need for the matter to be debated on the Floor of the House. If there were no obvious need even for such an evidence session, any single matter could be raised with witnesses at other evidence sessions.

26. Clearly there could be circumstances in which the Committee would see a full inquiry as necessary. This would usually be when an Inquiry revealed a need for major changes by the regulator. In these cases, the Committee would have the benefit of a detailed, independent and forensic report.

27. If this provision were in place:

(a) The Committee would already have reports into RBS and HBOS.

(b) It would be for the Committee, not the regulator, to decide if inquiries into other banking collapses was appropriate.

(c) The Committee would not have to decline to consider significant financial scandals—it could ask the Speaker to send the requisite letter, obtain a report, and then decide what level of response was necessary. At present it has to allow significant matters to go by without investigation.

(d) MPs would also have a way of forcing an Inquiry when the Committee's timetable did not permit a full inquiry (eg over the RDR).

28. The risk of unwelcome intrusion from Brussels might be reduced—a national mechanism for independent investigation could avert European level inquiry when an EU directive was involved.

29. The Commons would acquire a greater ability to direct the overall thrust of regulation—for example, there seems a greater appetite for protection for the least well off and promotion of savings to families on, say, twice average national income among MPs than among the regulators who seem intent on delivering the best possible regulation of advice to millionaires. This sort of high level choice ought to be made by the Commons, not the regulator.

30. While we cannot be sure, there is enough evidence that individuals spotted the danger of financial disaster in the run up to the Credit Crunch (see for instance "Masters of Nothing") for one to believe that the chances of a disaster being averted would significantly increase should there be a mechanism for MPs and the Committee to demand a proper inquiry and report. Suppose, for instance, that a S14 inquiry had been established into the regulators' understanding of quality of lending to commercial businesses by the main banks in 2005. Would HBOS and some others have been rescued?

October 2011

Written evidence submitted by the Financial Services Consumer Panel

Introduction

The Financial Services Consumer Panel has a statutory role in financial services regulation which will continue under the new regulatory regime with the Financial Conduct Authority (FCA). Consequently we are taking a close interest in the development of both the statutory framework on which the new structure is founded and the evolution of the new regulatory authorities.

We are pleased to have this opportunity to submit evidence to the Committee's timely inquiry into the FCA. There are many aspects of the FCA's approach as currently articulated that we support, but there are also a number of areas where more information is needed and we have set these out in our evidence. We want the move from Financial Services Authority to Financial Conduct Authority to be a transformative change rather than a name change. This means getting the legislation, powers and resources of the FCA right so that it can deliver a fundamentally different and better system of financial services regulation.

Executive Summary

We have set out in this evidence our responses to the questions asked by the Committee and the key points are summarised below. The success of the FCA overall will, we believe, be as dependent on its budget and ability to retain the right people with the right balance of skills and expertise as it will be on the adequacy of its legal powers.

We also need to see specific proposals from the FSA/FCA about how it intends to put the intentions and aspirations set out in the June 2011 FCA approach document[1] into practice. In the meantime we have based our evidence principally on what is set out in the approach document and the draft Financial Services Bill.

The key points are:

- Greater clarity is needed around the FCA's objectives, which seem unduly complicated and insufficiently aligned to consumer outcomes. We are concerned that the FCA might rely on disclosure to fulfil its consumer protection objective, which would not be appropriate or effective.
- We support strong competition powers for the FCA, with concurrent powers in line with other industry regulators.
- The FCA will need a sound economic understanding of the way relevant markets operate as this will underpin almost everything that the new regulator will do. Economic analysts will need to be involved in policy development from the outset and be in a position to challenge the FCA's senior management where necessary.
- The FCA needs to set objectives and success measures now, not as an add-on when the strategic planning process is over.
- More information is required about the FCA's risk appetite/tolerance.
- The suitability of the FCA's powers will rely in part on the FCA's interpretation of those powers and its policy on exercising them. Again, we would like to hear more from the FCA on this.
- We would like to see an explicit presumption in favour of publication of FCA action on financial promotions and other disciplinary action.
- Arrangements for co-ordination and working with EU and some domestic regulators and other bodies need to be clarified to ensure there are no gaps, particularly with the European supervisory authorities of which the FCA will not be a member.

Are the objectives of the FCA clear and appropriate?

1. We think the objectives of the FCA could and should be clearer.

2. The FCA's strategic objective will be to protect and enhance confidence in the UK's financial system. It will have three operational objectives including facilitating efficiency and choice in the market for financial services, securing an "appropriate degree of protection" for consumers and protecting and enhancing the integrity of the UK financial system. Finally, it must also promote competition in the market.

3. This seems both unduly complicated and opaque in terms of what the FCA can be expected to deliver in practice. It should be possible to recast the FCA's objectives to make them better and more closely aligned with good consumer outcomes. For example, we believe the FCA's third operational objective should be amended to "promoting efficiency, *access* and choice in the market for certain types of services", bringing explicitly within remit the issue of financial inclusion. We have called for this in our evidence to the Joint Committee on the draft Financial Services Bill.[2]

4. The consumer protection objective is of particular relevance to the Panel. We agree with the requirements for the FCA to have regard to risk issues and consumers' needs for advice and accurate information. On this latter point however we strongly believe that information disclosure in itself is not sufficient to ensure consumer

[1] The Financial Conduct Authority: approach to regulation at www.fsa.gov.uk

[2] 2 September 2011, at www.fs-cp.org.uk

protection. The FCA cannot rely on disclosure in fulfilling its consumer protection obligations. The FSA has in the past recognised that disclosure is not a panacea for consumer protection[3] and the FCA must not backtrack on this.

Should the FCA have a primary duty to promote competition as recommended by the Treasury Select Committee and Independent Commission on Banking? How should this work in practice?

5. The Panel supports strong competition powers for the FCA. We believe the FCA should have an objective to promote effective competition that improves consumer outcomes in retail and wholesale markets. Requiring the FCA only to discharge its general functions in a way which promotes competition, when this is compatible with its other objectives, is not a strong or clear enough obligation.

6. The starting point should be the assumption that the FCA is the lead on competition powers in financial services. In our response to the draft Financial Services Bill, we said that the FCA should have concurrent powers in line with other industry regulators, allowing it to use its expertise to carry out market investigations, and refer to the Competition Commission (or its successor) only if structural change needs to be considered. It should be possible to address supercomplaints regarding financial services to the FCA, with consumer bodies, including the Panel, able to apply for designated status. This can best be achieved by means of a high level competition objective and specific rule-making powers for the FCA.

7. As the June 2011 approach document stated, the FCA will need a sound economic understanding of the way relevant markets operate. The required approach is significantly different to that of the FSA, both analytically and culturally. Clearly, "economic understanding" of this depth and magnitude will be a significant aspect of the FCA's work, underlying almost everything that it will do, including addressing competition issues. This cannot be achieved in practice unless the FCA has in place the right resources—people, technology, budget and access to information—from the start. Analysts should be an integral part of policy development teams in the FCA, and be in a position to challenge senior policy-makers strongly when proposals are not supported by comprehensive research.

8. We support the approach set out in the FCA paper on pricing. Value for money is one of the most important considerations for consumers thinking of buying a financial product and we see this concept as an integral part of the principle of Treating Customers Fairly, as well as an important feature of the FCA's competition duty. This will be a significant shift away from the FSA's remit and culture and, again, the groundwork in terms of resources and strategy has to be addressed.

Does the FCA's approach to regulation, as outlined in the FSA's June 2011 document, represent an improvement on that of the FSA?

9. A good regulatory regime will deliver better and fairer outcomes for consumers. There is still a long way to go before we can be sure the FCA will do this more effectively than the FSA. It is difficult to make an assessment of the FCA's approach on the basis of the June 2011 document and the relatively limited information that has been provided since then. It is for the FSA and FCA to turn the aims and ambitions set out in the approach document into reality.

10. It will be important for the FCA to be able to assess the impact of its new regulatory approach as well as its own performance, and to be able to demonstrate that impact objectively. Success measurement (and comparison with the outcomes of the FSA's approach) cannot work effectively if it is a bolt-on or afterthought to the work of the organisation and we would like to see the FSA/FCA developing performance measures now, including objectives, timelines and milestones alongside or preferably as an integral part of the regulatory and operational approach. We would like the main focus of FCA success measures to be better consumer outcomes, rather than for example solely indicators that are activity and not achievement-based.

11. Particular attention will need to be paid to the success of the FCA's consumer engagement strategy, on which we have yet to see firm proposals from the FSA. Whatever model or approach is decided on, it is clearly a key feature of the new regulatory regime and is something on which the FSA seemed to struggle to deliver. We would expect the FCA to assess what it has achieved as a result of its consumer engagement strategy, how that impacted on policy decisions and how it could be improved. We see this as an area which is likely to be subject to continuing development and refinement and the FCA will need to be sensitive to shifting demands on its resources. We would also like the FCA to give early thought to defining the consumer outcomes it is seeking from its work on financial inclusion, as well as its own internal objectives and success criteria in this area.

12. In recent times the FSA has undergone a change in behaviour in areas such as enforcement, where it has begun to adopt a tougher stance than we have seen before. We were encouraged by Hector Sants' speech[4] at the FCA Conference in June this year when he spoke frankly of the FCA's "more interventionist regulatory stance" and recognised the need for the FCA to have "more resources" and "more powers" than its predecessor organisation. This augurs well for the FCA, but apart from confirmation that the FCA will not be operating a

[3] 7 April 2005, speech by John Tiner to the FSA Insurance Sector Conference, at www.fsa.gov.uk
[4] 28 June 2011 speech by Hector Sants, Chief Executive of the FSA, at www.fsa.gov.uk

zero-failure regime,[5] the approach document gave no real indication or impression of the risk appetite/tolerance of the new regime. In the context of "credible deterrence"[6] there was reference to lower tolerance for consumer detriment, implying perhaps a lower tolerance than the FSA of non-compliance in every aspect of its remit. But there was no explicit confirmation of that in the document.

13. Our earlier discussions with the FSA executive and impressions of the approach document as a whole have raised expectations that the FCA will be a proactive regulator acting decisively and on a pre-emptive basis to address failings in the financial services markets. If that proves not to be the case, consumer trust and confidence in the new regulator may well fall away very quickly, so the FCA should "start as it means to go on" with high profile, robust action.

14. While looking to the future it is important the FCA learns from the experiences of the past. On 11 December 2000, Howard Davis said[7] on publication of the FSA's Progress Report on Building the New Regulator, published earlier that year: "And most of all, consumers supported the idea of a proactive regulator, one which tried to anticipate and head off consumer problems in advance, rather than has been sadly the case too often in the ancient regime, coming along afterwards to clear up the mess."

15. It seems to us that some of the challenges for the new FCA are exactly the same as the FSA faced over ten years ago. Given the early commitment of the FSA to a proactive, anticipatory regulatory regime and the inability of the organisation to deliver it, it seems likely that either the resources or powers of the FSA were insufficient or inadequate. We want to be sure that this does not happen again. In particular, the new legislative framework needs to be unambiguous about the powers needed to support proactive intervention.

16. To achieve this, the ambition in the approach document will have to be carried forward in the powers, culture and ethos of the new organisation, as well as in its day-to-day operations. It is often the less tangible and less measurable changes that present the greatest challenge to an organisation, but without such transformative change consumers will still not have the assertive and committed regulator they need.

To whom should the FCA be accountable? Are the lines of accountability clear?

17. The FCA is of course ultimately accountable to Parliament, Government and the public. We have no particular concerns in this area.

18. The Panel has focused on the accountability and governance arrangements between the Panel and the FCA and we are satisfied that there is a sound foundation for the Panel to continue its input into the FCA. In this context it is particularly important that the requirement on the FCA to publish a response to representations received, regardless of whether it is in favour of such representations, is carried forward. We have raised elsewhere[8] the concerns we have about the absence of a similar statutory relationship between the Panel and the Prudential Regulation Authority (PRA) and Financial Policy Committee.

Are the powers of the FCA suitable? Will their exercise be subject to appropriate scrutiny? How should the FCA be interacting with industry as well as using its intervention powers?

19. The suitability of the FCA's powers is to some degree governed by the FCA's interpretation of and policy on exercising those powers, and much of this remains to be seen.

20. In addition to the FCA's competition powers, which we have commented on elsewhere in this evidence, the Panel has to date focused on three key areas.

21. *Product intervention*: we strongly support the product intervention power. This will assist the FCA in preventing inappropriate products reaching the market, while also giving consumers access to a wide range of financial products that meet a diverse set of needs and aspirations, and that have been subject to appropriate internal and regulatory scrutiny both at the design stage and during subsequent product development.

22. The FSA has stated that the FCA will not provide product kitemarking, approval and authorisation (other than for those products authorised by the FSA under the current regime). Although this is only one aspect of the new regulatory toolkit we think that setting limitations at this point seems contrary to the desire to take full advantage of the opportunity to develop a new approach to conduct regulation.

23. *Financial promotions:* the new power to take action on misleading financial promotions and to have a duty to publish that fact, are significant moves towards greater regulatory transparency, which we support. This should also enable early action to prevent detriment, with consumers better placed to take decisions and other market participants being made aware of unacceptable marketing practices. We would however like to see an explicit presumption in favour of publication of specific and identifiable action included in the Financial Services Bill. This would remove any possible ambiguity about the powers of the FCA in this area.

[5] Page 21 of the approach document
[6] Pages 25 and 26 of the approach document
[7] 11 December 2000, speech by Howard Davis (then Chairman of the FSA) to the FSA Conference "A Radical Approach to Regulation" at www.fsa.gov.uk
[8] The Panel's evidence to the Joint Committee on the draft Financial Services Bill at www.fs-cp.org.uk

24. *Publication of disciplinary action and other regulatory information: w*e support the new power to enable the FCA to disclose the fact that a warning notice has been issued in relation to proposed disciplinary action, but we believe the requirement for the FCA to consult those involved—implying that the subject's consent could be required for publication—should be clarified to allow immediate publication without consultation where it considers there is a risk of consumer detriment. Without such a change the requirement to consult and allow representations could slow the entire process and lead to consumers continuing to make potentially irreversible decisions based on unsuitable or incomplete information, depending on the nature of the disciplinary issue. The FCA should also be able to publish information collected in pursuit of its regulatory objectives (such as complaints data) to inform consumers and raise standards of industry behaviour. We have addressed this in our evidence to the Joint Committee on the draft Financial Services Bill.

25. We have not focused on how the FCA should be interacting with firms and we have no comments on that.

How will the break up of the FSA work in practice? Issues of coordination and information sharing between the FCA and the PRA

26. On the matter of the break-up of the FSA, the Panel's principal concerns so far have been the work not being undertaken by the FSA as a consequence of the need to dedicate resources to the transition to the FCA and PRA; and the impact on the transitioning organisation of staff attrition. We are conscious that the FSA has taken an incremental approach to transition and that there has already been an internal management restructure to reflect more closely the anticipated external structure of the FCA and PRA.

27. In its most recent Business Plan[9] the FSA set out the estimated cost of the regulatory change from the FSA to the FCA/PRA. With, broadly speaking, no overall increase in budget earmarked to manage this change there has inevitably been some diversion of resources from the FSA's "business as usual", although we have been reassured by the statements in the Business Plan that the FSA will continue to deliver its existing business priorities. We have been particularly pleased that the FSA has continued its work on the Retail Distribution Review, which should bring about profound change and great improvement in the investment distribution sector and the Mortgage Market Review, where we have been closely engaged with the FSA on policy development. We are not aware at this stage of any specific conduct-focused work streams with a significant consumer impact that have not been undertaken as a result of the transitional resource constraints, but we will continue to monitor this.

28. The impact of the loss of staff is more difficult to assess and no doubt the FSA will be better placed to provide evidence to the Committee.

29. The FCA approach document set out how the FCA would co-ordinate with firms, HM Treasury and other regulatory bodies including the PRA and Financial Policy Committee. While the arrangements seemed appropriate they also looked overly complex in practice, an issue that could impact on information sharing, governance and accountability.

30. As regards the FCA and PRA in particular we understand that arrangements will be put in place that will include, but will not be limited to, supervisory colleges; working together in areas such as authorisation; notification of intended enforcement action; discussions about putting in place common standards and rules for risks which are directly relevant to both authorities' responsibilities; and co-ordination in setting policy and rules. All this seems likely to take up a considerable amount of time and staff resources and will be a significant factor when the FCA is intending to take regulatory action of almost any kind. There needs to be a streamlined, pragmatic method of ensuring effective communication, without being overwhelmed by process, with clear accountability.

How should the FCA be interacting with other domestic regulators? Do EU regulation initiatives restrict or enhance the work of the FCA? Will the FCA be able effectively to engage with the EU supervisory authorities?

31. No decision has yet been made on the possible transfer of regulatory responsibility for consumer credit to the FCA. We would like to see evidence that the FSA is thinking now about how it would deal with both a transfer and consequent operational issues, given the potential scale and scope of an extended remit, as well as how it would interact with other bodies in the event that the transfer does not take place. Additionally we would like to learn more about how the FCA intends to approach its new powers to refer matters formally to the Office of Fair Trading, which was not explored within the approach document. We believe that the FCA's interaction with other domestic regulators and relevant non-regulatory bodies should be supported by legal powers to exchange information when the need arises and a published Memorandum of Understanding on which the regulatory relationship should be shaped. Interaction between regulators should cover policy development as well as operational issues.

32. Although not regulators, a further key area will be the operational and strategic relationship between the FCA, the Financial Ombudsman Service, The Financial Services Compensation Scheme and the Money Advice Service. We strongly support ease and frequency of information sharing between the FCA and these three independent organisations, both in terms of consumer and market awareness and co-ordinating approaches to

[9] Published March 2011 at www.fsa.gov.uk

emerging or crystallised risk, unintended consequences of regulatory action and wider implications issues.[10] We do not wish to see rapid and effective engagement hindered by complex process. We hope that the new Coordination Committee will facilitate the necessary level of debate and decision-making.

33. EU initiatives have a significant impact on national regulation and the Panel is engaged with and supportive of many of the policy proposals that relate to retail financial services consumers. It is important that the FCA is able to engage effectively with EU supervisory authorities and others.

34. From the European perspective the FCA approach document lacked sufficient detail about how the FCA would input to the European Supervisory Authorities of which it is not a member, although we understand that a Memorandum of Understanding will be put in place to provide the basic framework for co-ordination between HM Treasury, the Bank of England, the PRA and the FCA. This will have to be clear and comprehensive in what is a complex area. In our view it is not sufficient to say that, as stated in the approach document, the FCA "will support the PRA in representing UK interests in European Insurance and Occupational Pensions Authority and the European Banking Authority".[11] Far more detail needs to be made available to ensure the FCA's input on conduct issues is not in any way diluted as a result of a drawn-out process for UK representation.

October 2011

Written evidence submitted by Prudential

1. Prudential plc is an international financial services group with significant operations in the UK, Asia and the United States. Our purpose is to promote the financial well-being of our customers and their families, with a particular focus on saving for retirement and income in retirement. Our portfolio of well-known and respected brands has attracted approximately 25 million customers worldwide. Prudential plc is also one of the UK's largest institutional investors and therefore our comments reflect our views both as a leading financial services group as well as a major institutional investor.

2. We welcome the opportunity to provide evidence to the Treasury Select Committee on this important topic. We support the submission and evidence provided by the Association of British Insurers, but wish to make a number of specific points.

Executive Summary

3. Whilst we broadly support the current objectives, we believe that the operational objective could be broadened to allow the FSA to engage with wider policy issues such as under-saving.

4. We do not support the omission from the FCA's regulatory principles of the need for international competitiveness and appropriate innovation to be taken into account when making regulatory decisions.

5. Regarding the FCA's new powers the Government should legislate for procedural fairness, ensuring that the industry has absolute clarity on how and when the powers will be used.

6. We would be concerned about the creation of an environment in which the use of new powers could potentially lead to distrust between the regulators and the industry, and between industry and consumers.

7. The FCA will need very careful management and the involvement of highly competent people able to use their judgement appropriately.

8. Given that regulatory reform is to be implemented at the same time (1 January 2013) as major changes to cross-border insurance regulation (Solvency II), there will be a need for continued and effective engagement on international issues. We therefore support the requirement for a Memorandum of Understanding (MoU) to exist between the Treasury, the Bank of England, the PRA and the FCA to facilitate international coordination.

Evidence

Are the objectives of the Financial Conduct Authority (FCA) clear and appropriate?

9. Whilst we broadly support the current objectives, we believe that the operational objective to "secure an appropriate degree of protection for consumers" could be more constructively defined by adding "whilst promoting positive consumer outcomes." This would allow the FCA to take into account how their regulatory decisions will impact on wider policy issues such as under-saving. We have welcomed clarification that the FCA will remain a neutral balanced regulator rather than act as a "champion" to a particular group of stakeholders.

10. In addition we do not support the omission from the FCA's regulatory principles of the need for international competitiveness and appropriate innovation to be taken into account when making regulatory decisions. It is crucial that successful cross-border organisations such as Prudential plc's asset management

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[10] The FSA, Financial Ombudsman Service and Office of Fair Trading published a feedback statement in March 2011 (FS11/2) setting out their approach to dealing with emerging risks and mass claims, including the establishment of a Coordination Committee at www.fsa.gov.uk

[11] Page 44 of the FCA approach document

arm, M&G Investments, continue to be able to compete on a level playing field internationally and that the UK does not lose out to other countries wishing to increase their domiciled funds. The financial services sector represents 10% of UK GDP and it is our view that regulatory action should recognise the wider potential impact on jobs and growth.

Should the FCA have a primary duty to promote competition as recommended by the Treasury Select Committee and Independent Commission on Banking? How should this work in practice?

11. We support the requirement for the FCA to discharge its functions (where possible) in a way which promotes competition. The FCA will need to have the appropriate skills to undertake complex market and economic analysis, ensuring that any mandate is not used in an unbalanced way.

12. There will need to be clarity on the interaction between the FCA and the proposed Competition and Markets Authority.

Does the FCA's approach to regulation, as outlined in the Financial Services Authority (FSA)'s June 2011 document, represent an improvement on that of the FSA?

13. We believe it is too early to tell if the change in approach will be an improvement. We look forward to engaging with the FCA as they further develop their approach.

To whom should the FCA be accountable? Are the lines of accountability clear?

14. We support the proposed arrangements, particularly the new Markets Panel as this provides a recognition of the importance of wholesale financial markets to the UK.

Are the powers of the FCA suitable? Will their exercise be subject to appropriate scrutiny? How should the FCA be interacting with industry as well as using its intervention powers?

15. We would be concerned about the creation of an environment in which the use of new powers could potentially lead to distrust between the regulators and the industry, and between industry and consumers.

16. One of our key concerns is that a more intrusive strategy by the FCA will need very careful management and the involvement of highly competent people able to use their judgement appropriately.

17. Greater use of "naming and shaming", if used without due process and without access to recourse in a timely manner, has the potential to result in disproportionate reputational damage for firms. It will be vital to ensure that the possibility of any public censure gives firms the opportunity to be presented with and challenge any allegations in advance, and that an effective appeals process is maintained.

18. There is a need to be aware of the unintended consequences of new rules on product development and innovation, creating the possibility of a reduced range of products for consumers. Ensuring that the Retail Distribution Review (RDR) and EU regulations in this area are taken into account as policy is developed will also be important.

19. The Government should legislate for procedural fairness, ensuring that the industry has absolute clarity on how and when the powers will be used. The measures should be applied appropriately and proportionately. We would welcome the addition of recourse procedures to protect the financial services industry against any inappropriate use of regulatory powers beyond that which is embedded within regulation and law. Such, procedures should be transparent and easy to use, where the rights of both parties are respected.

How will the break-up of the FSA work in practice? Issues of coordination and information sharing between the FCA and the Prudential Regulation Authority (PRA)

20. We support the possibility of combining the supervisory activities of the FCA and PRA for dual-regulated firms.

21. We also welcome the inclusion of a unit for "insurance groups" within the new FSA transitory structure. We would suggest that one of its activities should be to ensure that the prudential regulation of subsidiary asset managers, such as M&G Investments, by the FCA does not result in duplicative regulation by the PRA. Regulations should be applied consistently to subsidiary asset managers and independent asset managers, ensuring a level playing field.

22. We would also suggest that the PRA and FCA adopt a shared set of "quality assurance" operating principles, which could include the requirement to ensure consistency, simplicity, clarity and certainty in the application of judgement-led supervision. These principles could be subjected to ongoing evaluation.

How should the FCA be interacting with other domestic regulators? For example, the FCA's relationship with the Bank of England and Financial Ombudsman Service

23. The Bank of England's regulation of payment systems, settlement systems and central counterparty recognised clearing houses (RCHs) will require close coordination with the FCA, in view of the FCA's remit for the regulation of markets.

24. Similarly, the Bank of England will need to work closely with the FCA, in view of the FCA's representation on ESMA. This will ensure that it is fully aware of important developments that will affect systemically important infrastructure, such as the European Markets Infrastructure Regulation (EMIR).

25. We support the independent role of FOS and the need for an MoU between FOS and the FCA. Regarding the publication of FOS determinations, the use of greater transparency will need to ensure that data is accurate and contextualised, and that FOS has clear objectives which result in helpful outcomes for consumers.

How should the FCA be interacting with international regulators? Do EU regulation initiatives restrict or enhance the work of the FCA? Will the FCA be able effectively to engage with the EU supervisory authorities?

26. Given that regulatory reform is to be implemented at the same time (1 January 2013) as major changes to cross-border insurance regulation (Solvency II), there will be a need for continued and effective engagement on international issues. We therefore support the requirement for a Memorandum of Understanding (MoU) to exist between the Treasury, the Bank of England, the PRA and the FCA to facilitate international coordination.

27. The recognition that core insurance activities are not systemically important should continue to be made in international fora where the Treasury and Bank of England have representation, particularly the Financial Stability Board and European Systemic Risk Board.

28. It is also crucial that the PRA and FCA have sufficient insurance expertise and resources at Board and senior level to engage with the European Insurance and Occupational Pensions Authority (EIOPA) and European Securities and Markets Authority (ESMA) respectively.

October 2011

Written evidence submitted by Legal & General Group

We welcome the opportunity to respond to the Treasury Select Committee (TSC) call for evidence. Our submission focuses on the key issues of accountability and due process; these have not yet been addressed adequately in the draft legislation.

Overview

We believe that the crisis was a failure of regulators as much as it was a failure of regulation. The Government must therefore ensure that their reforms deliver not only a robust regulatory framework that respects the rights and interests of all stakeholders, but also drives a positive change in regulatory culture and approach.

The risks inherent in the Government's new, judgment-led philosophy of regulation are openly acknowledged by Government and regulators; however, they remain insufficiently mitigated through robust due process and transparency of regulatory policy and intent.

Real-time regulation is an attractive aspiration; but its practice must be tempered by real-time checks and balances if the UK regulatory system is to remain credible and effective. Natural justice and the prevention of unnecessary harm must not be sacrificed as collateral damage in the pursuit of expediency and dispatch. For example; we are extremely concerned that warning notices and decisions regarding financial promotions could be published before sufficient evidence has been established and no fault has been proven. The risk of consumer alarm and the consequent damage that ill-judged disclosures can cause to the financial system mean that firms must be given the right to challenge poor regulatory judgments *before* irrevocable harm is caused.

Of course, transparency—of regulatory risk appetites, strategies, policies and rationales—is essential if public confidence is to be restored and firms are to understand and meet stakeholder expectations. This must be delivered through effective consultation processes and lines of accountability to Parliament and other stakeholders.

Regulatory standards must also be proportionate, and tailored appropriately. The new regime as a whole must deliver differentiated and relevant regulation of insurers; we are not banks, and as major contributors to the UK economy, we must be regulated according to the real risks we pose.

We see two challenges in the detail of the FCA's proposed approach. First, the authority appears intent on intervening and directing individual firms in a highly detailed and specific way—to a degree approximating to shadow directorship. Yet there is no mechanism for the FCA to be held accountable to firms' stakeholders for the consequences of such interventions, and no liability for the FCA when they damage unreasonably the interests of those stakeholders.

We are also doubtful that the regulators will ever be able to deploy staff with sufficient in-depth knowledge and experience to deliver safely and credibly the quality of supervision expected, particularly in relation to large and sophisticated firms. To plug such significant skill gaps, the FCA may therefore over-use its s.166 powers. We see an increasing trend in the FSA's use of these powers to conduct what are routine, albeit large-scale, regulatory investigations at significant cost to firms. This gives rise to material non-transparent additions to the costs of regulation that must be better understood and quantified in the assessment of the costs of the reform agenda.

Detailed Response

1. *Are the objectives of the Financial Conduct Authority (FCA) clear and appropriate?*

The FCA's objectives are not wrong, but the real priorities for conduct regulation must be better clarified. We detect a growing overlap between public policy and regulatory objectives; the Government must therefore acknowledge and clarify its expectations more explicitly.

We understand that we should respect the underlying intent, as well as the letter, of regulation. In the same way, the FCA should be required to take account of the Government's public policy objectives in exercising its functions. The FSA has itself noted that the FCA will need to prioritise and make trade-offs between its objectives; a required public policy overlay would help to inform such decisions.

For example; the Government has said it believes the FCA will have sufficient mandate to address financial exclusion through its efficiency and choice objective and the regulatory principle of proportionality. But it has also said (in an earlier consultation) that financial inclusion is a matter of "social, rather than regulatory", policy. This implicit expectation that the FCA will have due regard for a social policy must be clarified and, if necessary, made explicit.

The regulatory principles also fail to address the risk that regulatory interventions can cause, as well as prevent, irrational behaviours on the part of consumers. The FCA must be required to anticipate and avoid perverse outcomes, such as making it easier for a consumer to borrow than to save.

We also suggest that a further regulatory principle should be specified: that the FCA should avoid unduly restricting consumer access to suitable financial products and services.

2. *Should the FCA have a primary duty to promote competition as recommended by the Treasury Select Committee and Independent Commission on Banking? How should this work in practice?*

The ability of markets to respond appropriately to competition and consumer demands should not be unduly constrained by regulation. The regulators must therefore have regard to the competitive impacts of their actions.

A regulatory framework for competition already exists in the UK and we agree that to duplicate or supplement this in the FCA's objectives would create ambiguity and confusion. The ICB's suggestion, for example, that the FCA could "tackle barriers to entry" is unnecessary, given that these can already be addressed under the existing competition framework. Attending to such issues would distract the FCA from pursuing more relevant objectives, and the costs of duplication would, we believe, ultimately fall upon consumers and taxpayers.

The promotion of competition should rightly figure as a subordinate duty only, acting as an influencing factor for the FCA in deciding how to discharge its functions. This duty should, we suggest, be extended to include the promotion of UK competitiveness. The FCA cannot be allowed to regulate UK markets disproportionately within the global economy without being held accountable for the outcomes.

The inclusion of the promotion of "efficiency" is also risky. Economic efficiency does not necessarily further consumer protection or confidence in a market; to require its promotion could further drive the FCA towards an excessively interventionist approach. We have already heard an FSA NED expound a theory that controlling a market through product regulation and intervention will increase competition by rendering it more efficient; however, it is widely recognised that poorly judged interventions can lead to significant adverse impacts and increased costs to consumers. Market interventions must be used infrequently and with great skill and discretion; and e are not confident at the FCA's ability to deploy such skills.

3. *Does the FCA's approach to regulation, as outlined in the Financial Services Authority (FSA)'s June 2011 document, represent an improvement on that of the FSA?*

It would be virtually pointless to appraise the two authorities on the information currently available. Clearly, the FSA adapted its regulatory approach following the financial crisis, but the Government chose not to allow time for any benefits to be seen. The extent to which the FCA's approach will be new, or simply a further evolution of the FSA, is also unclear—the "approach" document was written by the FSA and must be taken as a statement of its own intent, rather than a disinterested description of an entity not yet in existence.

We have also noted with concern the increasingly negative tone of FSA statements, which we hope is not indicative of the future approach of the FCA. Industry must have confidence that, in exercising its powers, the FCA will be directed by a balanced and objective regulatory culture. The FSA must now begin to demonstrate a capability to evolve in a more positive direction.

We also perceive certain key dangers in the proposed new approach and powers for the FCA. While robust regulation is a positive asset for the UK financial system, we believe that an extreme and over-interventionist approach will, in the longer term, damage the credibility and viability of the UK as a financial centre. It is essential, in the interests of maintaining confidence in the regulatory system, that the values of objectivity, proportionality and fairness are not sacrificed in the pursuit of speedy intervention.

As noted above we are not confident that the FSA/FCA will be able to recruit staff with the skills and experience needed to assess and comment on the business models and strategies of significant industry participants. Effective judgment-led regulation requires a high standard of intellectual capability, professional competence and relevant industry experience at a senior level. These qualities are currently sparse within the FSA, where they have had little success in acquiring them so far.

4. *To whom should the FCA be accountable? Are the lines of accountability clear?*

The FCA should be accountable to Parliament, to the public and to those it regulates, in respect of the effectiveness and the consequences of its exercise of its functions.

The Government and FSA have acknowledged that the regulators "may get it wrong" in exercising judgment—particularly when giving directions and intervening in firms. This is easy to say, but we see no genuine acknowledgment of the severity of harm that "getting it wrong" will have on individual firms, consumers and the financial industry as a whole. We see little requirement for the regulator to be properly accountable for the consequences of its mistakes.

The Government has suggested its "transparency" measures will enhance accountability. But allowing, for example, the publication of Warning Notices is not a valid "transparency" measure. It is an opportunity for the regulator to pre-judge the outcome of its enforcement process without any protection for the firm exposed to that judgment.

The Government has, in our view, made it too acceptable for the regulator to "get it wrong" and avoid facing the consequences, particularly under the misguided banner of "transparency". It has set a mandate that is over-focused on speed of intervention and the exercise of "judgment" without mitigating the inherent risks by requiring demonstrably robust, complete and valid evidence and analysis, or by subjecting regulatory judgments to effective checks and balances.

In contrast, there has been little *real* transparency—allowing scrutiny and challenge—of many of the decisions currently being made to implement the new regime. We have not yet seen, and may not have an opportunity to challenge, the many MoUs on which the system will rely. Nor has the Government required sufficient ongoing transparency of the regulators' risk appetites, standards and basis for judgments.

5. *Are the powers of the FCA suitable? Will their exercise be subject to appropriate scrutiny? How should the FCA be interacting with industry and well as using its intervention powers?*

We are deeply concerned that, in its response to the Joint Scrutiny Committee, the FSA urged them to "resist industry pressure to cut back [the proposed statutory] powers or to constrain their use in a way which would be likely to make them ineffective in practice". Allowing a policeman to shoot a suspect on sight might be considered an effective deterrent to crime, but would not result in justice being served.

The Upper Tribunal provides an essential mitigant to the risks inherent in a new authority with new, untested powers. It must therefore be properly empowered to prevent regulatory error. The continuing oversight of the Regulatory Decisions Committee, worryingly absent from statements about the new architecture, should also be confirmed and embedded in statute.

Publication of Warning Notices

The publication of warning notices *before* an investigation is a reckless policy, particularly given the current lack of consumer confidence in the financial system. It also flies in the face of principles of natural justice that require each party to have the opportunity to ask questions and challenge the evidence of the other.

Experience shows that it is essential not to alarm consumers unnecessarily about the status of their financial services providers. The objective evidence to substantiate regulatory concerns typically only arises in the course of a full regulatory investigation, but it is unlikely that the tentative nature of allegations made in Warning Notices will be well understood by the average customer. in the new European structure the rules will be made in Europe.

For firms, the reputational damage arising from inappropriate and over-hasty disclosures of regulatory concerns could be huge, destroying not only value but also its very stability. Although a firm must be consulted before publication, this gives no real protection from the regulator simply overriding any objections they raise.

We therefore resist strongly the FSA's request to the Joint Scrutiny Committee to remove this basic protection and suggest instead that the publication power either be withdrawn or properly constrained by a robust independent appeal process, such as the Upper Tribunal.

Unregulated Parent Entities

We believe the proposals in respect of unregulated parent entities are, as yet, insufficiently well-articulated. We are concerned that a holding company could be directed to act in a way that could be considered to breach the fiduciary duties of directors and their duties to shareholders.

Product Intervention

We are concerned by the proposal to allow a temporary exemption from consultation on product intervention rules. The power is substantially untested and, if poorly exercised, could give rise to material reductions in innovation and consequent loss of consumer choice. The need for the exemption is in any case unclear, given the general exemption from consultation already available; and the tests for its application—"expedient" and "necessary"—appear to allow consultation to be avoided on the basis of mere convenience.

6. *How will the break-up of the FSA work in practice? Issues of coordination and information sharing between the FCA and the Prudential Regulation Authority (PRA)*

We remain uncertain as to exactly how the PRA and FCA will coordinate, and are unable to comment on whether their plans are likely to be robust and effective. Coherent, consistent coordination is vital to the success of this reform and we are disappointed that so much detail will be left to subordinated legislation and MoUs. That these will not be subject to consultation is simply unacceptable.

The coordination requirements must include a requirement for the authorities to work together to minimise the aggregate burden that their regulatory activities place upon regulated entities.

It should not be permissible for two Authorities to impose a penalty on a regulated or authorised person in respect of offences that are materially the same.

7. *How should the FCA be interacting with other domestic regulators? For example, the FCA's relationship with the Bank of England and Financial Ombudsman Service*

The Financial Ombudman Service is not a "regulator". That the TSC have referred to it in such terms illustrates our particular concern.

We fully support the FOS as a mechanism for resolving individual disputes between consumers and regulated firms, and have no wish to constrain its scope or power to deliver this service.

However; the FOS is not, and is not intended to be, a regulator. Its decisions in respect of individual cases must not be allowed to vary or supplement existing regulatory and legal requirements, beyond the scope of an individual decision.

The current requirement for firms to "take account of" FOS decisions means that an individual decision binds a firm to act in accordance with it more widely. This is reasonable when the matter on which the decision turned is non-regulatory, such as an operational error, or highlights a failure to comply with current regulation; it is right that firms should correct the root cause of a valid complaint, for the benefit of its other customers.

We also recognise that the facts of the individual case may give rise to a FOS decision that is inconsistent with, or adds to or varies the relevant regulatory requirements. This is also reasonable, and is consistent with the FOS duty to decide a case on the basis of what it considers "fair and reasonable in all the circumstances". However, in this instance, such a decision *must not* be held to apply more widely; otherwise, the FOS decision has effectively overturned or varied established law or regulation.

We do not believe it is the Government's intention to empower the FOS to act as a crypto-regulator, and therefore seek a correction of this flaw in the current and future regime. We accept individual complaints can highlight a regulatory void, or a need for change. However, when this appears to be the case, there must be an independent mechanism to evaluate such regulatory insights and develop an appropriate policy response. That activity falls within the scope, powers and competence of the FCA; this distinction in roles between the FOS and the FCA must therefore now be clarified and preserved, to avoid further disruption to development of regulatory standards.

8. *How should the FCA be interacting with international regulators? Do EU regulation initiatives restrict or enhance the work of the FCA? Will the FCA be able effectively to engage with the EU supervisory authorities?*

The role of European regulatory authorities in determining the content and application of financial regulation is recognised as increasingly dominant—a fact explicitly recognised by Hector Sants: "in the new European structure the rules will be made in Europe". The discretion available to the UK regulators will therefore be limited, and expectations around their exercise of judgment, or scope to gold-plate EU requirements, must be consistent with this. The real challenge for the Government and the FCA now will be to gain enough traction and credibility in Europe to ensure that EU regulation is proportionate and rational for the UK.

The FCA must be required to have regard to emerging EU regulation, and should be directed to avoid making regulatory changes in the UK on matters that could reasonably be expected to be addressed by EU measures. It must be held specifically accountable for any unnecessary change costs generated by pre-empting EU legislation that are not supported by a clear and pressing regulatory imperative that could not be addressed by alternative, lower cost, options. The Government should also provide clearer guidelines about the circumstances in which gold-plating of EU regulation will be acceptable; the default approach to transposition must be pure copy-out.

October 2011

Written evidence submitted by St. James's Place Wealth Management

Introduction

1. We are writing to provide written evidence in response to the Treasury Committee announcement on 15 September 2011 of an inquiry into the Financial Conduct Authority (FCA). We are very happy to provide further detail where required or explain our thoughts to the Committee in person.

Who We Are

2. St. James's Place Group is the leading provider of wealth management advice in the UK. We include three UK authorised "retail" firms; St. James's Place Wealth Management, which is a Directly Authorised Personal Investment Firm with circa 1,500 Appointed Representatives; St. James's Place Unit Trust Group, which is the Authorised Fund Manager of four NURS, including a property fund and twenty five UCITS unit trusts; and St. James's Place UK, which is an authorised long term insurer manufacturing life and pension products.

Executive Summary

3. St. James's Place welcomes the establishment of the FCA and is generally supportive of its objectives. We believe that there is a need for better protection for the consumer and the overall priorities for the organisation are broadly correct.

4. We recognise the need for greater oversight of the market and the need to provide regulators with the ability to intervene where they have identified a clear market risk. That said, market intervention and the power to ban products should be a last resort for a regulator and should be taken after detailed consultation and investigation. The FCA should strive to find the balance between effective oversight and establishing a healthy and competitive market. Intervention and overly burdensome regulation can often have the effect of reducing competition which will ultimately be detrimental to consumer choice.

5. Our greatest concern with the new structure is the prospect of dual regulation for insurers. In our case, our retail business will be regulated by the FCA while our insurance business will also be regulated by the Prudential Regulation Authority (PRA). We anticipate this creating a considerable burden by duplicating regulation, contacts and oversight. Our strong preference would be to establish a very clear framework that co-ordinates regulation between the two different bodies having responsibility for a firm to avoid duplication and ensure consistency.

6. In addition, we do not believe that the definitions of the sectors that should be regulated by each body are satisfactory. Our insurance business is scheduled to be regulated by the PRA because an insurer typically "manages significant risks on its balance sheet". It is, however, wrong to claim that *all* insurance businesses carry such a significant systemic risk. We believe that a weighting of risk needs to be established above which firms should and should not be monitored by the PRA as is proposed for investment firms.

7. On accountability, we believe that the decisions of the Complaints Commissioner should be binding on the FCA. We believe that a strong and diverse board and a requirement to report regularly to Parliament and Government should ensure that the body is accountable.

8. We believe that particular efforts should be made to ensure that the FCA is accountable to industry. It is often very difficult to establish an effective dialogue with the FSA and we believe that the FCA should be better at answering questions and explaining processes to the industry.

9. We support the Treasury Committee's and the Independent Commission on Banking (ICB) recommendation to make promoting competition a primary duty for the FCA. The impact of regulation on competition should be considered and there should be a general recognition by the FCA that competition is an effective means of ensuring choice and transparency for the consumer.

10. Lastly, the FSA must work very hard to ensure a smooth transition to the FCA and make sure that current initiatives are not prejudiced. The Retail Distribution Review (RDR) is an example of an ongoing initiative that cannot afford any more uncertainty over content or timing.

Answers to the Questions Posed by the Committee

Are the objectives of the Financial Conduct Authority clear and appropriate?

11. We are generally supportive of the objectives of the FCA and are satisfied that these objectives are clear and appropriate. While we are supportive of the overall objectives of the FCA, we are aware of the potential for contradiction between the strategic objective to promote efficiency and choice and the increased power and willingness to intervene in the market. We caution that any market intervention must be targeted and specific to firms or individuals acting in breach of rules rather than an entire product class for example. We also advise the FCA to consider the consequences for competition when choosing to intervene. Regulation can often act as a barrier to entry and a thriving and competitive market is an effective means of ensuring value and transparency for the consumer.

12. There is a lack of clarity for firms that are set to be regulated by both the FCA and PRA and we believe that there is urgent need for a coordinating framework that will provide consistency and avoid duplication in such cases. Our concerns in this area are highlighted in more detail in paragraphs 24–28.

13. Finally, we are concerned about the impact of the transition on some of the FSA's current initiatives. The RDR is the most obvious example of a major regulatory initiative that cannot afford any further uncertainty over its content or timing.

Should the FCA have a primary duty to promote competition as recommended by the Treasury Select Committee and Independent Commission on Banking? How should this work in practice?

14. We support the FCA having a greater role to play in promoting competition in the market and would welcome the ICB's recommendation that the FCA have a primary duty to promote competition. Greater competition will benefit consumers by providing access to more products and information at a better price.

15. Promoting competition will require a change of mindset within the FCA. The objective should be to ensure that firms provide their clients with products that they want and need, and supporting this should be the driving force for the new regulator. There should be a general recognition that consumers benefit from competition and it is an effective means of providing consumer protection and transparency.

16. Before an intervention is considered, the impact on the market should be carefully considered, particularly the effect on the market in terms of creating barriers to entry. Intervention must be targeted at individual wrong-doers rather than entire product classes or industry sectors as heavy handed intervention in the market will reduce consumer choice.

17. The RDR and PRIPS initiatives will both increase pre-contract disclosure on the type of products being sold and the costs of each product. If implemented correctly and in collaboration with the industry, these initiatives should provide consumers with a greater understanding of what they are buying, how much it costs and the ability to compare products.

Does the FCA's approach to regulation, as outlined in the Financial Services Authority (FSA)'s June 2011 document, represent an improvement on that of the FSA?

18. St. James's Place is broadly supportive of the intentions and approach of the FCA. The widespread miss-selling of financial products over the past two decades has not been effectively tackled by the FSA and a new approach to conduct regulation is evidently required. It is important to caveat this statement with the understanding that the FSA have already taken action to improve their regulatory approach and that even greater regulatory intervention risks moving to the opposite end of the risk spectrum and could result in prohibiting innovation of financial products that are in the interests of clients.

19. We are very concerned about the prospect of dual regulation for insurance firms. Our thoughts are set out in more detail in paragraphs 24–28, but we anticipate considerable confusion as a result of having two separate bodies regulate our business. We strongly urge the committee to consider the detailed framework required for appropriate co-ordination between the different bodies with overall responsibility for a business.

To whom should the FCA be accountable? Are the lines of accountability clear?

20. We are generally satisfied with the level of accountability of the FCA. In practice, it will be important that its Board is sufficiently strong and diversified. We believe that the Complaints Commissioner's decisions should be binding on the FCA.

21. The FCA should be accountable to firms and the decision making process should be transparent. Given the additional powers that the FCA will have to intervene in the market, we feel that it is very important that industry is consulted and can participate in this process.

Are the powers of the FCA suitable? Will their exercise be subject to appropriate scrutiny? How should the FCA be interacting with industry as well as using its intervention powers?

22. As noted above, we believe that the FCA should be transparent and it should establish an ongoing dialogue with industry. In the case of the RDR, it should be possible to speak to the relevant officials in the FSA to discuss timings and the possible content of proposals. The delay on the paper on legacy payments for example, has not been explained to the industry which has been forced to guess the date of publication and what it may mean for businesses. We would prefer a situation where we can speak to an official and get clarity on this type of issue quickly and easily.

23. We do not oppose the powers of the FCA to intervene in the market in principle, but we believe that this should be a last resort and follow an extensive consultation. Market intervention and banning products is extremely disruptive and can reduce competition. We believe that the FCA should consider such action very carefully, particularly in the context of its duties to create efficiency and choice.

24. Providing FCA with the ability to disclose the commencement of formal enforcement action against firm before such action has been fully justified is disappointing. The potential reputational impact of misjudged enforcement action has not been taken into consideration nor the possible legislative basis for such publication. Publishing a warning notice prior to full investigation pre-supposes guilt, meaning the firm in question is denied the opportunity for a proper determination as to the validity of the proposed warning. Any such publication should be closely reviewed by an external, independent, third party to ensure that release is based upon an adequate case assessment and strictly justified. There is also a risk that such disclosures could undermine confidence in the financial services industry, unnecessarily in cases where warning notices were later proven not to be with just foundation. The role of FCA is to enhance confidence in financial services and this power appears to be in direct conflict with the main objective of the regulator. There is clear potential here for the regulator to malignly influence the orderly working of the market, resulting in a negative economic impact and reducing shareholder value as a consequence of their actions.

How will the break-up of the FSA work in practice? Issues of coordination and information sharing between the FCA and the PRA

25. We are extremely concerned about the prospect of dual regulation for insurance firms. We can only see this as placing more burdens on business and providing less clarity from regulators. The Treasury's consultation "A new approach to financial regulation" states that supervision of "financial institutions that manage significant risks on their balance sheets will be carried out by … the Prudential Regulation Authority". It should be made clear that the financial crisis was primarily caused by the risks emanating from the banking sector and to assume all insurers carry such significant risk and should fall within the remit of PRA is not correct. There should be a weighting of risk above which insurers will come under the umbrella of PRA. Insurers below this level can be monitored by the FCA, as per investment firms. For insurers such as St. James's Place, where the vast majority of liabilities to policyholders are directly related to the value of assets held in unitised funds, PRA regulation is not necessarily warranted. We ask that consideration should be given to developing a set of tests or indicators for a threshold below which insurers could be regulated solely by the FCA, with appropriate reference to the PRA in all relevant matters.

26. A key focus when determining the remit of the different regulatory forms will be to ensure there is no regulatory overlap. There is a danger that where there is more than one regulator supervising a firm that each will regulate on certain matters leading to two levels of regulation on the same issue. It is vital that this does not happen and, as far as possible, firms should only be regulated by one authority so there are efficiencies in contacts, reporting etc. The Treasury Consultation says that one of the failings of the current regime was that the "fragmentation of responsibilities has had a number of dysfunctional results". It is important that this is not repeated again within the new regime.

27. If this requires a review of Financial Services and Markets Act 2000 then this is what should happen. It is important that this is effectively implemented otherwise it is not clear how the alteration to structure will achieve the benefits suggested within the cost/benefit analysis.

28. Co-operation between the regulators is to be supported, but there should be some clear ordering of authority where agreement cannot be reached and to ensure a level of consistency from the firm's viewpoint. This is where a clear framework on key decisions for dual regulated firms is essential. All attempts should be made to avoid duplication of effort or involve firms in internal discussions between regulators.

29. We are concerned that the transition may lead to a lack of clarity for ongoing initiatives. The RDR is the most obvious example. While we are on course to be RDR-compliant, the initiative has been beset by u-turns and a lack of clarity on issues such as VAT, commissions, rebates and platforms. In addition, there is uncertainty over exactly how this initiative will fit in with MiFID and PRIPS. The industry and the FSA/FCA cannot afford for there to be any further uncertainty that might be caused by the transition.

How should the FCA be interacting with other domestic regulators? For example, the FCA's relationship with the Bank of England and Financial Ombudsman Service

30. We do not have detailed comments on this point.

How should the FCA be interacting with international regulators? Do EU regulation initiatives restrict or enhance the work of the FCA? Will the FCA be able effectively to engage with the EU supervisory authorities?

31. The FCA should work extremely closely with other domestic regulators as well as with the European institutions and the European Commission in particular. The FSA will be well aware of the importance of co-ordination between the UK and the EU on financial regulation. Close co-ordination is essential to ensure that such UK initiatives as the RDR are not undermined by EU legislation such as MiFID 2 and PRIPs. We are aware that the FSA has worked very hard to build support in the European Commission for the objectives of the RDR, but despite this level of engagement, industry does not yet have the desired level of clarity as to how the RDR will ultimately be affected by European legislation.

32. The effect of competing regulation from abroad is that the UK is often forced to "gold-plate" EU legislation meaning that UK firms are at a disadvantage to their European counterparts. Once again, this appears to be a likely outcome with the RDR. We support the efforts by the FSA to engage in Europe and to improve the quality of regulation in the UK, but we believe that the FSA's (and the FCA's) objective should be to create a level playing field and not to place UK businesses at a competitive disadvantage.

33. In terms of engaging with European supervisory authorities, there is a danger that the UK's engagement could be diminished either through changes in personnel leading to underrepresentation on the supervisory bodies, or in engagement practices. Clarity will need to be provided to European regulators on the responsibilities of the FCA and it is vitally important that there is continuity in the UK's approach in Europe.

34. European regulators are becoming increasingly powerful with broader powers to intervene in domestic markets or hold domestic regulators to account. The review of MiFID for example, is set to give additional powers to regulators to ban products that they believe pose risks to the market. Any such move should be a last resort that follows a detailed investigation. We are concerned about the potential for wrong decisions to be made when the ability to ban products is given to a regulator that does not have day-to-day oversight of the UK market.

35. We are also concerned that the newly formed supervisory bodies are currently under-staffed and have been assigned very large workloads for Level 2 implementation of major regulations such as EMIR and CRDIV. It is not yet clear that they have the structures, capacity or expertise in place to implement and police these complex regulatory initiatives. It is vital that the UK remains represented in the new supervisory bodies both in terms of representation amongst the personnel and on the relevant management boards.

October 2011

Written evidence submitted by the Smaller Businesses Practitioner Panel

Introduction

1. The Smaller Businesses Practitioner Panel is due to become a statutory body in the FCA's structure for industry engagement under the Government's proposals. The current Smaller Businesses Practitioner Panel was set up by the Financial Services Authority in recognition of the need to have a specific Panel to represent the interests of smaller firms to work alongside the Practitioner Panel and Consumer Panel. More details of our role and membership are at Appendix 1.

2. Smaller firms represent around 90% of all regulated firms—some 15,000 businesses, providing financial advice and other services in towns and cities throughout the UK. We represent those firms who are considered by the FSA to be smaller firms—the vast majority do not have a dedicated relationship manager within the FSA's supervision model. Instead they submit regulatory returns giving trading data and other information on a monthly basis, and interaction with the regulator is mainly through a contact centre.

Treasury Committee Questions

Are the objectives of the Financial Conduct Authority (FCA) clear and appropriate?

3. We believe that the objectives of the FCA are reasonably clear and appropriate. However, we would like to see a greater emphasis on ensuring that the FCA acts in a fair and unbiased manner in interpreting and balancing the three operational objectives. We are concerned that the single broad definition of consumers may encourage a "one size fits all" approach to regulation. We have fought hard to encourage the FSA to avoid this unless clearly justified.

4. From a smaller firm point of view, it is vital that the burden or restriction of new regulations on small firms is proportionate to the benefits to the financial system. Therefore, the third objective of "protecting and enhancing the integrity of the UK financial system" must not be subsumed under the weight of protection for consumers, and the FCA must have a clear regard to the need for an "appropriate" degree of protection.

5. There is a danger that any increase in regulatory cost and burden, along with other current changes in the regulatory landscape taking place as a result of European requirements and the RDR, will undermine the viability of many smaller financial firms going forward. Both the Government and the regulators must guard

against a situation where the drive towards financial stability puts so great a burden on firms that only the largest firms are able to survive, as the smaller firms, which are sometimes more nimble and more attuned to specific customers' needs, are unable to compete. This in turn would create an added risk in the UK financial system, with a concentration of service in the hands of a few big firms, as has been seen recently in the banking system.

6. We believe that the FCA operational objective of promoting efficiency and choice in the market, should be amended to include the promotion of access to products and services. This would help to encourage the FCA to consider the variety of types of consumer as well as types of firm. It would help in terms of the FCA's remit in financial advice and taking over the responsibility for the Retail Distribution Review. We have advocated that all people, at whatever level of income and investment, should have easy access to fair and not misleading financial advice.

7. Our concern about the interpretation of the objectives is also linked to the lack of attention which has been given so far in the balance between consumer protection and consumer responsibility. Consumer responsibility has been maintained in the regulatory principles. However, under the FSA, the role of consumer responsibility has been ambiguous: it has never been properly defined how the regulator should translate this into policy, beyond vague references to *caveat emptor.*

Should the FCA have a primary duty to promote competition as recommended by the Treasury Select Committee and Independent Commission on Banking? How should this work in practice?

8. We believe that the Government's current positioning of the duty of the FCA to promote competition is reasonable. From the small firms' point of view, we would like the FCA's duty to discharge its general functions in a way which promotes competition, to be interpreted in a way which means it also has a responsibility to consider the burden that it is putting on smaller firms through its actions. For instance, when cost and benefit analysis is being undertaken, there should be a requirement to consider the specific impact on small firms—not only of that proposal, but on the cumulative requirements being made.

9. We believe that the FCA should maintain an awareness of the way that small firms contribute to the diversity of the UK financial system, and work to ensure this diversity is maintained, by ensuring that smaller firms are not overburdened by unnecessary regulatory requirements. Diversity in this context would assist in creating consumer choice and at the same time, reduce risk of dependence on a limited number of firms. It is also often the smaller firms that are able to introduce the innovations that consumers want and then force the larger firms to follow suit. For instance it was Nationwide Building Society who stood up to Barclays in 2000, to stop charging for cash withdrawals from cashpoint machines.

Does the FCA's approach to regulation, as outlined in the Financial Services Authority (FSA)'s June 2011 document, represent an improvement on that of the FSA?

10. We do not believe that the FCA's Approach will represent a guaranteed improvement to that of the FSA. Our concerns are based on the impact of the split; the overall approach of the FCA; consumer responsibility and cost as set out below.

11. The new structure of two regulators as proposed has an inherent danger of overlap and underlap between the regulators. Although there is an overall statutory duty to coordinate, we believe that this split will introduce additional risks and greater costs into the system, which will not necessarily be better for the significant number of smaller firms which will be dual regulated. Firms' business models, particularly for smaller firms, are not split according to prudential and conduct issues. This means that reporting to different regulators on these lines will place a heavier regulatory burden especially on small firms.

12. We note that, although there are a number of references to the role of the FCA as a prudential as well as conduct regulator, there is only one paragraph of detail on Prudential Supervision (5.12) in the FCA Approach document. Far more firms will have their prudential supervision undertaken by the FCA. It is therefore difficult to comment on this aspect of the FCA's regulation, and it is worrying that so little attention seems to have been paid to this role for the FCA. This has important implications for the recruitment and retention of appropriate staff to understand prudential supervision when it is not seen as a priority at the FCA.

13. It is also crucial that the FCA is an unbiased regulator, who is able to take a balanced approach. The FCA launch conference in June 2011 focused on retail consumer issues and seemed overly critical of the industry, with little recognition of the good work being undertaken by many firms. We believe that it is important for the FCA to be seen as a fair and balanced policeman of the system if the FCA is to comply with its objective of protecting and enhancing confidence in the UK financial system.

14. As part of our drive to ensure balance in the FCA, we have also urged the FSA to provide more detail on how it will incorporate the principle of consumer responsibility into its work. This is one of the six regulatory principles, and as set out at the beginning of Chapter 3 of the FCA Approach document. However, consumer responsibility is not discussed as an element of the regulatory approach in Chapter 4, or listed in the additional regards for policy and rule making as set out in paragraph 5.33 of Chapter 5.

15. We are also concerned about how the FCA will undertake a role in interacting with individual consumers. The FCA Approach document states (3.11 and 4.11) that the FCA plans to do more than the FSA has done to engage directly with consumers. We are concerned about the cost and potential duplication of this. The industry is already funding the Money Advice Service (MAS), so it seems that the FCA should be doing less than the FSA has done to engage directly with consumers, as much of the role should now be undertaken by MAS. As it is, we are also concerned about the lack of cost control and accountability of MAS, which is detailed in the following answer.

16. We are disappointed that there is little reference to how smaller firms will be regulated in both the Government's consultation and in the FCA Approach document. This will be all the more important as there have been indications that fewer firms will be relationship managed in the new system. Therefore, there must be an effective means both of monitoring the compliance of firms, and of providing guidance to firms on how best to comply with the regulatory requirements.

To whom should the FCA be accountable? Are the lines of accountability clear?

17. We support the proposal for the FCA to be accountable to parliament, with input from the industry and consumer representatives through a structure of consultation and openness. We are pleased that the Smaller Businesses Practitioner Panel will be made a statutory panel under this legislation. We know that the FCA will be more interventionist and more judgement-led in pursuit of better consumer outcomes. Therefore it is important that there are clear accountability mechanisms within the regulator as well as externally to Parliament and government.

18. We are particularly concerned about coordination going forward and believe that more could be done about accountability in this space. This is particularly as the latest consultation stated: "The Government expects that, over time, the regulators will develop their own regulatory culture and approach to engagement with firms" (2.135, June 2011). We have argued that there should be practitioner panel input to the policies of the PRA as well as the FCA, and that the panels should be linked so that practitioners have a forum to comment on whether there is an increased regulatory burden through conflicting requirements being developed by the PRA and FCA.

19. We would also like to be assured that there will be rigorous cost control within the FCA, as the FCA Approach document discusses a number of new initiatives, with little reference to where current FSA activities will be dropped. We were assured in the Government's first consultation that the new regulator will not cost more for those who will only have a single regulator (although of course the significant number of smaller firms who will be dual regulated are likely to have an increase in regulatory costs). However, we note that the Treasury's latest Consultation document (June 2011) stated that the total cost of the two regulator model would be £770 million. This is based on a cost of around £170 million to transition to the new system, with around £75 million a year from 2013–20 in additional costs of regulation, of which costs to the industry are estimated as between £25 million and £50 million a year. These costs are exceptionally difficult to predict. However, the essential lesson from such estimates must be that there need to be extremely tight cost and operational controls in both regulators: both must work to ensure excellent co-ordination, with no over- or under-laps, to ensure that any additional costs to the industry do not spiral out of control.

Are the powers of the FCA suitable? Will their exercise be subject to appropriate scrutiny? How should the FCA be interacting with industry as well as using its intervention powers?

20. Much is being made of the FCA's new product intervention powers, which we support as one element within the regulatory toolkit, but not necessarily as the most important one. This is because it is more often the way that products are sold that creates problems, rather than the products themselves. We also do not believe that the product intervention powers provide a simple solution: significant liabilities and pressure could build up on the FCA if the product intervention powers are not used appropriately. In cases where either firms or consumers suffer detriment as a result of the regulator's actions, it is unclear what the regulator's liabilities and obligations would be. There should be a means to hold the regulator to account (and allow it to learn) from making the wrong decisions.

21. The FCA will have a duty to interact with industry through the Independent Panels and through consultation on policy developments. We also believe it will be the quality and experience of its staff which will help to make the FCA an effective regulator. It needs to have people who have the depth of understanding necessary to get under the skin of firms and understand the key regulatory issues. The FSA has recently suffered from a loss of senior management due to the restructuring changes. The FCA will need to focus on recruiting top quality senior staff with experience of the industry to assist Martin Wheatley as the new Chief Executive.

22. We have questioned the FSA recently on their increasing use of s166 reports, when firms are directed by the regulator to appoint a skilled person, such as a firm of accountants, to undertake an investigation into an area where it needs more information. We believe that s166 reports, if appropriately used, can be an efficient regulatory tool which implements a "polluter pays" principle. However, there have been recent indications that the hurdle for implementation is not being set high enough, and the costs associated with them are disproportionate.

23. We remain concerned about the implementation of the FCA's new power to publicise enforcement action earlier on in the process. We appreciate that the Government introduced more safeguards in its June 2011 consultation. Nevertheless, we remain concerned that, for smaller firms who are subsequently found not to have done anything wrong, this may be extremely damaging as the reputation of smaller firms can be key to their survival. This seems contrary to the laws of natural justice, and it could also have a negative impact on consumer confidence overall.

How will the break-up of the FSA work in practice? Issues of coordination and information sharing between the FCA and the Prudential Regulation Authority (PRA)

24. The FSA's planning for change, and coordination with the Bank of England in setting up the two new organisations, seems to be generally well managed. Plans are well advanced for a gradual break up of the FSA and re-allocation of staff to the two new organisations. Our overriding concern is that, from the point of view of firms, these regulatory changes are coming on top of other major changes such as the implementation of the RDR and Solvency II, as well as an economic downturn. Firms will already be having to change their documentation and incorporate the rule book changes into their operations, and the break up of the FSA is applying yet more pressure and cost onto firms.

25. We are still awaiting the Memorandum of Understanding (MOU) and details of how coordination will work in practice. We hope that the MOU will be available for public discussion during the pre-legislative scrutiny stage. We also suggest that there should be a requirement for consultation on any changes to the MOU, and that the annual review of the MOU should require input from the FCA's statutory Panels before being submitted to Parliament.

26. We have called for the duty to coordinate between the PRA and FCA to be embedded into the regulatory principles as well as being a statutory duty for both regulators. For those small firms who will be swept up into dual regulation by the PRA as well as the FCA, it will be vital to ensure that coordination of regulatory requirements is considered at every level.

27. As stated above, we have argued that there should be practitioner panel input to the policies of the PRA as well as the FCA, and that the panels should be linked so that practitioners have a forum to comment on whether there is an increased regulatory burden through conflicting requirements being developed by the PRA and FCA.

How should the FCA be interacting with other domestic regulators? For example, the FCA's relationship with the Bank of England and Financial Ombudsman Service

28. The FCA's relationship with the Bank of England will be critical in the new structure. This is not only in terms of coordination with the PRA, but also with regard to the Bank's role with the FPC and the Bank's direct responsibility for regulation of clearing and settlements. There must be openness and clear coordination of roles as they affect the overall financial services market in the UK.

29. We believe that the Government should take this opportunity to review the relationship between the conduct regulator and the Financial Ombudsman Service (FOS). It could introduce a new governance facility for the FOS within the new framework, which could be in the FCA. This could address two issues: firstly, there are times when firms would like to appeal against ombudsman decisions when they are taken in relation to the wider fairness concept, but seem contradictory to FSA rules. The cost of taking such a case to judicial review is prohibitive for most small firms. So an alternative mechanism for doing so would be welcomed by the industry and set a fairer system for all. Secondly, individual ombudsman decisions can set precedents which have wider implications for potentially thousands of other cases. We believe that there should be a more formal and transparent process for decision making on cases requiring regulatory or legal clarification. This could include a right for trade bodies and other interested parties to refer such decisions to a governance body within the FCA.

30. We continue to be concerned about the lack of cost control on the set up of the Money Advice Service (MAS). For example, this year, the Practitioner Panels made it clear to the FSA Board that there was not enough detail and justification of the annual budget for MAS, and yet the programme has gone ahead, with funding nevertheless being demanded from industry through FSA administered levies. We believe there must be more public discussion of the costs and benefits of the Money Advice Service, and suggest that the FCA should be given a specific responsibility to review cost control at MAS.

31. We are also concerned that the funding requirements for FSCS have the potential to cause severe problems for smaller firms who may be suddenly called on to fund significant requirements. We do not believe that the regulators should stand back and not consider the impact of FSCS levies on firms. We would like the FCA and PRA to be given a responsibility to undertake a full impact analysis when reviewing FSCS funding and have regard to the impact of FSCS levies on the financial stability of firms. Given the recent huge FSCS levies, the Panel wishes to reiterate the point that it is very difficult for smaller businesses to cope with such large, unplanned cost expenditures. It would make no sense going forward to have a prudential regulator which did not recognise that large FSCS (or other regulatory) levies could threaten small firm viability and lead to many small firms closing with the resultant reduction in consumer choice and increase in concentration risk.

How should the FCA be interacting with international regulators? Do EU regulation initiatives restrict or enhance the work of the FCA? Will the FCA be able effectively to engage with the EU supervisory authorities?

32. As UK regulation is more and more directed by EU and international initiatives, it is vital that the FCA is fully involved and has full credibility in the development of new policies. The FSA's work in international and European arenas has improved over the past few years. This must not be allowed to be lost in the context of regulatory restructuring.

33. The new UK structure does not map directly on to the EU structure. In its June consultation, the Government recognised that coordination and cooperation will be important in this area. It will be vital that the FCA is fully coordinated with the other UK regulatory authorities when it takes the UK's single seat on bodies such as ESMA where the PRA and Bank will also have interests.

October 2011

Written evidence submitted by GC100

The GC100 is the association for general counsel and company secretaries of companies in the FTSE100. There are currently more than 120 members of the group, representing some 90 issuers.

The GC100 welcomes the opportunity to comment on this inquiry, with particular reference to two questions in the context of the FCA's supervision of markets. Please note that the views expressed in the submission do not necessarily reflect the views of each and every member of the GC100 or their employing companies.

Executive Summary

1. We were initially pleased to discover that the UKLA is to remain part of the FCA (and not become part of another regulator as suggested in a government consultation in 2010). However, due to the FCA's focus on the financial services industry, as opposed to on listed markets, we feel that the decision to retain the UKLA within the FCA has negated a lot of the perceived advantages. Indeed, we strongly disagree with the approach to align market/UKLA regulation with other aspects of FSMA or FSA/FCA responsibilities. We are very concerned by this approach as we believe that the role of the UKLA as competent authority for listing and prospectuses is, by its very nature, fundamentally different from the prudential, supervisory, conduct and consumer aspects of the FSA/FCA. We do not think that the FCA objectives are right or appropriate for the UKLA as competent authority.

2. In addition, we believe that the regime for skilled person's reports (under section 166 of FSMA) for listed companies is unjustified and uncompetitive. We see the ability to require skilled person's reports for listed companies as a significant increase in the powers and regulatory toolkit of the FSA/FCA. We do not believe that there has been a market failure which would justify this significant policy development and there has been no explanation of any other justification for the proposal to make listed companies subject to a regime which, so far, has been confined to companies which are regulated for financial services purposes. Also, there has been no cost benefit analysis to demonstrate that this is a proportionate approach. The power could impose significant costs on listed issuers. It could materially alter the whole approach of listed issuers and the UKLA to each other and will make the UK a less attractive jurisdiction for issuers deciding where to list. In this regard, we do not think that the powers of the FCA are suitable.

Are the objectives of the FCA clear and appropriate?

3. We consider that the regulatory focus, objectives and priorities of the UKLA are, and should remain, different from those of the rest of the FCA. Primary and secondary market regulation is based strongly on market transparency designed to enable investors to make decisions in an appropriate timeframe and based on the correct information (via prospectuses, RIS disclosures or annual/interim reports). This ties into market abuse regulation but has very little link to supervisory, prudential or conduct regulation which will be the main focus of the FCA.

4. On this basis we believe that the decision to try and bring the UKLA and Part VI within the general legislative framework of the FCA rather than retaining a discrete Part VI regime is misguided and unlikely to lead to any positive benefit in terms of protecting or enhancing confidence in the UK financial system. We believe a function like the UKLA needs to have a UK competitiveness focus in terms of objectives and that, whilst possibly appropriate for a prudential and conduct regulator, the FCA objectives are not appropriate for a market/transparency type regulator. We believe that the "have regards to" duties set out in section 73 of FSMA remain appropriate for the different kind of regulatory function the UKLA carries out which is neither prudential nor conduct based.

5. We appreciate that the FSA and HM Treasury may feel this kind of approach to statutory objectives and responsibilities may in some way be responsible for regulatory failures over the past few years. In a supervisory and prudential context this may be the case. However we do not believe it is appropriate to take this approach with primary market regulation. The general role and obligation of the UKLA is to ensure appropriate

disclosure by issuers at the correct time and then the market and securities holders can make decisions, including decisions to take legal action against issuers if they believe the information is lacking in any material respect, based on such information.

6. In summary, we strongly disagree with the approach to align market/UKLA regulation with other aspects of FSMA or FSA/FCA responsibilities. We are very concerned by this approach as we believe that the role of the UKLA as competent authority for listing and prospectuses is, by its very nature, fundamentally different from the prudential, supervisory, conduct and consumer aspects of the FSA/FCA. We do not think that the FCA objectives are right or appropriate for the UKLA as competent authority. We think that the listed markets and UKLA would benefit from the FCA, in its capacity as UKLA, having objectives and "have regard to" factors more closely aligned to those set out in section 73 of FSMA than those proposed for the FCA which do not appear appropriate to us to a market and disclosure based regulator.

Are the powers of the FCA suitable?

7. We believe that the regime for skilled person's reports (under section 166 of FSMA) for listed companies is unjustified and uncompetitive. We see the ability to require skilled person's reports for listed companies as a significant increase in the powers and regulatory toolkit of the FSA/FCA. We do not believe that there has been a market failure which would justify this significant policy development and there has been no explanation of any other justification for the proposal to make listed companies subject to a regime which, so far, has been confined to companies which are regulated for financial services purposes. Also, there has been no cost benefit analysis to demonstrate that this is a proportionate approach. We would see this as adding to the regulatory burden and cost of being listed in the UK, specifically for debt and specialist securities issuers, which in turn will make the UK a less attractive jurisdiction for issuers deciding where to list.

8. This may be an appropriate power, if used sparingly and sensibly, in relation to authorised firms but we do not consider this to be an appropriate tool for listed issuers and markets. It also appears to be the kind of tool which prudential and conduct regulators are becoming increasingly attracted to—the benefits of this are less clear. We are worried that such power, once in existence, will be used frequently and for matters which may be considered immaterial. We would suggest that rather than being a less onerous way of dealing with enforcement or pre-enforcement matters this regulatory tool is much more likely to be used regularly to deal with matters which are dealt with through dialogue and correspondence presently.

9. The area where the UKLA will want to use the power (if it is given to them) is to establish whether the Listing Principles are being complied with. When the Listing Principles were introduced the market was assured by the UKLA that they had no intention of enforcing the principles independently of a substantive breach of one of the other rules. We do not see any change in relation to the functioning of listed issuer markets which suggests this radical and costly change is justified and the UKLA has no need for this power.

10. One of the consequences of this procedure is that a firm may be guilty of no misconduct but still have to pay, sometimes very large amounts, to consultants to review and report on the way they achieve compliance. That may be appropriate for authorised firms where compliance with general requirements for systems and procedures are fundamental to their ability to comply with the rules. Such a power is disproportionate when applied to listed issuers.

Conclusion

11. As a general observation we do not consider there to have been market or regulatory failures in the listed markets in recent times. Indeed we believe that, despite failings in non-listing areas, all the empirical evidence is that the listing regime stood up well during times of extreme stress during the financial crisis and therefore we do not see that there is a need to change the supervision or regulatory framework of the existing listing regime. We also believe that to increase the regulatory burden without any fact based evidence of market failings is likely to lead to unnecessary and increased company costs at a time when there is a severe economic downturn, and is incompatible with the Government's stated aim of regulatory simplification and the cutting of needless "red tape", as well as making London a less competitive location for international listings.

October 2011

Written evidence submitted by CIFAS

CIFAS would like to thank you for the opportunity to respond to your inquiry into the Financial Conduct Authority.

As you will be aware, CIFAS is the UK's Fraud Prevention Service. A not-for-profit membership association, CIFAS represents both the private and—more recently—public sector. We are dedicated to the prevention of fraud, including staff fraud, and the identification of financial and related crime.

For over 20 years, CIFAS has brought together a range of private sector organisations to limit fraud losses and protect consumers. More recently, a number of public sector organisations have also joined us, including the Legal Services Commission, Financial Services Authority, and Student Loans Company.

Our 250 Members give us a unique understanding of the fraud landscape across the banking, credit, asset finance, retail credit, mail order, insurance, savings, telecommunications, and share dealing sectors. Since 2005, our Members have reported saving over £4 billion in fraud losses thanks to the reciprocal, secure, sharing of fraud data facilitated by CIFAS.

As an organisation dedicated to the prevention of fraud, CIFAS will respond to your inquiry primarily on issues related to our remit.

Are the objectives of the Financial Conduct Authority (FCA) clear and appropriate?

It is our view that the objectives of the FCA are largely well defined. However, we do have concerns regarding the issue of fraud prevention.

It is clear that Government sees the current system of financial regulation as unsatisfactory. The creation of the FCA and Prudential Regulation Authority (PRA) are two major efforts to address the inadequacy of the current system.

However, it is our view that there are wider efforts being undertaken across Government to tackle financial regulation and prevent financial crime which must be considered in the round with these reforms in order properly to tackle issues such as fraud.

For instance, the Counter Fraud Task Force (CFTF) being led by the Cabinet Office is considering how best to address fraud prevention across Government and its agencies.

In order for these new regulatory bodies to be effective, the best practice emerging from the CFTF must be hard-wired into the FCA and PRA in order for them to perform their functions in offering appropriate, informed and clear regulation.

Described as being a "consumer champion" within *A New Approach to Financial Regulation*, the FCA is listed as having an operational objective of "securing an appropriate degree of protection for consumers." CIFAS has two concerns with this assertion. First, that the already muddled financial crime prevention landscape is having another player added to it with ill-defined responsibilities. Second, that there is a risk that the FCA is created without reference to the best practice principles being formed by the CFTF. It is essential that Government moves in lockstep on this issue.

To whom should the FCA be accountable? Are the lines of accountability clear?

CIFAS has concerns as to the "fraud-framework" in which the FCA is to sit.

HM Treasury's consultation paper, *A New Approach to Financial Regulation*, goes into sparse detail on the relationships it will have with other financial crime prevention bodies such as the police, Serious Fraud Office, the Serious Organised Crime Agency, and National Fraud Authority. While it is suggested that it will maintain "key links" with these organisations, it is not clear how these relationships will work or indeed what value the FCA may add to the fraud prevention landscape.

In addition, the FCA is identified as taking over management of FIN-NET, the cross-Government fraud and financial crime network. Again, in absence of other information, we are concerned that this appears to be a "tidying-up" exercise with FIN-NET being passed from one regulator to another with no thought as to how its work will dovetail with other fraud bodies and in particular the CFTF.

CIFAS considers that the way the FCA will be constituted will make it essential for it to have a thorough understanding of best practice anti-fraud principles ahead of its inception. The FCA will need to understand the fraud landscape across a range of financial institutions in order to ensure that those businesses offer the best and most secure services for consumers within the resources available to them.

Finally, CIFAS considers that as a regulator and arbiter of consumer protection the FCA should itself demonstrate the best practice principles which it demands of others.

Our experience in preventing financial crime has made it clear that, for organisations to tackle fraud effectively, they must vet staff appropriately and ensure that they share, securely and in a structured and carefully controlled way, fraud data with other bodies. This is the standard which consumers expect their financial institutions to reach, and it follows that as a co-ordinator of private sector and cross-Government fraud and financial crime data the FCA should lead by example.

October 2011

Written evidence submitted by AXA UK Group

1. *Are the objectives of the Financial Conduct Authority (FCA) clear and appropriate?*

We feel that there is a fine balance between protecting consumers and imposing excessive regulations. The FCA must ensure in discharging its "functions in a way which promotes competition" that it considers the international character of financial services and the impact of any decision on the competitiveness of UK firms. The implementation of EU rules must not be "gold plated". This will ensure that UK firms can easily compete in Europe without additional onerous requirements and to help ensure that European firms with investments in UK financial services firms remain and do not withdraw from the UK market. We also think the regulatory principles as set out in the draft Bill should include the need for the regulators to recognise the international nature of financial services in order to maintain the competitive position of the UK.

The FCA should also consider the appropriate type of protection as well as the appropriate degree of protection afforded to consumers. This will help ensure that the protection being considered is proportionate to the benefit so that the industry can work effectively and provide product choice to the consumer.

The FCA will be the prudential regulator for most firms but the objectives do not reflect this. The FCA's objectives should therefore be developed to recognise this important function of the regulator.

2. *Should the FCA have a primary duty to promote competition as recommended by the Treasury Select Committee and Independent Commission on Banking? How should this work in practice?*

Competition provides for a healthy market and we note that the TSC recognised that competition is an effective means of protecting consumers' interests. We welcome the competition duty for the FCA which has been included within the draft Bill and as outlined in our response to question 1 feel this needs to be extended to ensure the FCA considers the international character of financial services.

The Government's consultation paper published with the draft Bill noted the fact that the FCA's strategy paper published in June 2011 would set out in more detail how the new approach to competition will be implemented. The FCA considered pricing as a means of addressing competition. We are not in favour of the FCA stipulating mandatory minimum standards for products and we would be very concerned if the FCA introduced price caps since this could stifle innovation and the competitive market. We are not in favour of the FCA restricting product choice for the majority of consumers in case a minority could suffer detriment. This could be achieved by restricting the way the product is distributed. Consumers must also take responsibility for the choices they make.

We agree with the Government's proposals as set out in section 140A to 140H of the draft Bill which maintains scrutiny of the regulation of financial services by the competition authority.

3. *Does the FCA's approach to regulation, as outlined in the Financial Services Authority (FSA)'s June 2011 document, represent an improvement on that of the FSA?*

The FCA's approach to regulation is at an early stage of development so it is difficult to say with certainty whether it will represent an improvement on that of the FSA. However we set out as follows some concerns with the proposals as outlined in the FSA's June 2011 document:

- The paper focused on the widespread problems that have arisen in recent years. However these have not necessarily been attributable to the product itself but the sales process. Firms are always looking to develop products to provide enhanced benefits which will benefit consumers. This provides a healthy competitive market. Therefore, we believe that the FCA should not just focus on products but also look at the sales process.
- The FCA intends to develop a high calibre team for business and market analysis. It is essential that this team has industry experience.
- We agree that the FCA should use a differentiated approach to protect different categories of consumers. The FCA intends to look at the information needs of consumers. It is essential that the quantity of information is balanced since too much information is not necessarily beneficial.
- We set out in our response to question 5 our concerns regarding the FCA's product intervention powers and approach to enforcement.
- We note that the FCA is committed to "building and sustaining effective relationships with consumers and their representative". There is risk in adopting this approach that the FCA could be seen as a "consumer champion" and this is not appropriate given the FCA's role as a regulatory authority. The FCA will have oversight of the money advice service and it should be this body that adopts these close working relationships with consumers and their representatives and acts as a consumer champion.
- We think the FCA should use the Money Advice Service to educate consumers on what they can expect from firms and the FCA. This will avoid duplication and additional costs to both firms and consumers.

— We agree that the FCA should maintain the FSA's approach to consultation as part of the rule-making process. If the FCA is looking to build on this approach and is seeking to develop more effective ways of getting feedback then the FCA should look at ways to improve this process both for consumers and firms. The FCA needs to be accountable to both consumers and firms.

— The FCA must ensure that when it publishes information about its "views on markets" and "the comparative performance of a firm" that data published is timely and accurate and is not seen to endorse one particular product, service or firm.

— Accountability is essential both within firms and the regulator. Therefore the FCA must maintain the appropriate internal systems and controls to ensure that the decisions it makes are accurate, reasonable and appropriate. The FCA's judgements must be based on facts and appropriate accountability measures put in place if the FCA decides to pursue an enforcement action.

— The FCA should be subject to the same type of internal governance as the firms it regulates which will help ensure the appropriate accountability measures are put in place.

— We are in favour of the FCA building on the FSA's use of cost benefit analysis and enhancing this approach through more rigorous analysis of consumer and market behaviour. This is essential to ensure that the cost of pursuing a particular policy approach does not outweigh the benefits or significantly impact the choice of consumers.

— We are in favour of a risk based approach to regulation. The FCA must ensure the appropriate internal systems are in place when developing its policy on early intervention to prevent detriment. Any decision to intervene must be taken at a senior level within the FCA.

4. *To whom should the FCA be accountable? Are the lines of accountability clear?*

We welcome the proposed Governance and accountability arrangement for the FCA as outlined in the draft Bill. However we are concerned about the weakening of the ability to challenge the regulator's decision as proposed in the Bill particularly in view of the regulator's more interventionist approach to regulation. We are concerned that the Upper Tribunal cannot express an opinion about the appropriate cause of regulatory actions as currently set out in section 133 (4) of FSMA, in the event that it does not uphold the FCA original regulatory decision.

5. *Are the powers of the FCA suitable? Will their exercise be subject to appropriate scrutiny? How should the FCA be interacting with industry as well as using its intervention powers?*

We are concerned about the FCA's enhanced role in influencing the products that are available in the market. We still do not believe the FCA requires these additional product intervention powers.

The widespread problems that have arisen in recent years have not necessarily been attributable to the product itself but the sales process. Firms are always looking to develop products to provide enhanced benefits which will benefit consumers. This provides a healthy competitive market. Therefore the FCA should not just focus on products but also look at the sales process.

We are not in favour of the regulator being involved in product design or stipulating mandatory minimum standards. We think this should be reached through industry level agreement and codes of practice. Regulatory involvement in product design could also stifle innovation and the competitive market place. We are also concerned this power may create an uneven playing field where products are being sold in the UK by an EU entity on a cross border basis.

We are not in favour of the new power to publish a warning notice indicating that enforcement action has commenced. This seems to be contrary to natural justice and the principle that an individual is innocent until proven guilty. We are particularly concerned that publishing a warning notice could ruin the reputation of both firms and individuals who may later be found not to be at fault. We also feel that if warning notices are to be given these must be directed at the relevant individual/firm only after the outcome of the full investigation/hearing. We recommend a review of the number of warning notices issued by the FSA compared with the number of final notices in order to assess whether this new power for early publication of enforcement action remains appropriate. The Bill also does not set out what action will be taken where a warning notice does not result in a final decision notice and how a firm or individual can clear their name.

We believe the FCA should be developing a culture of openness and dialogue with the firms it will regulate. These new FCA powers appear to run the risk of developing a culture which is aggressive towards the industry. We believe the FCA should not be given more proactive intervention powers before current and proposed regulatory changes to improve the financial services market take effect. These include for example the FSA's enhance supervisory approach, the Mortgage Market Review, the Retail Distribution Review, changes to Payment Protection insurance market etc.

6. *How will the break-up of the FSA work in practice? Issues of coordination and information sharing between the FCA and the Prudential Regulation Authority (PRA).*

We are concerned with the initial cost of implementing the changes as well as the potential ongoing supervisory costs due to the dual regulation of firms. The Government has estimated the cost of implementing the proposed changes to be between £195–325 million and ongoing costs of £25 million to £100 million. It is essential that regulatory costs are proportionate and represent value for money for customers who will ultimately finance regulatory costs. The cost of the proposal must not outweigh the benefits.

The primary legislation will specify the legal duty for the PRA and FCA to coordinate their activities which is essential for dual regulated firms to ensure a consistent and proportionate approach to regulation. The detail on how the PRA and FCA will coordinate these activities will be set out in a Memorandum of Understanding (MoU). It is essential to minimise regulatory overlap, that the regulators are open and transparent when creating these mechanisms. It is essential for the regulators to consult stakeholders when developing the MoU and this requirement should be set out in the primary legislation. We welcome the proposal that the Bank and the FSA will be required to produce a draft of the MoU in time for the introduction of the Bill to Parliament, however we think this should be available during the pre-legislative scrutiny process.

We remain concerned that there is the potential for the dual regulator/twin peaks approach to lead to considerable inefficiencies, additional costs and overlapping jurisdictions. It is essential that the PRA and FCA do not duplicate each others' activities.

We have previously commented in response to the Government's earlier consultation papers that a centralised body would be appropriate for the following activities:

- Authorisation of firms and individuals, including variations of permissions.
- Collection of all fees and levies.
- Inward and outward passporting.
- Notifiable events.
- Changes in control.
- Close links reporting.
- Changes to standing data.
- Appointed Representatives.
- A relationship manager to coordinate supervisory activities for dual regulated firms.

We feel that this will help ensure coordination of activities. This centralised body will have the appropriate expertise to provide both prudential and conduct approval and allows expertise to be built up in a centre of excellence which should create greater efficiency.

We are concerned that the proposed dual registration may cause confusion to consumers and it is essential that the proposals for registration meet the registration requirements of Article 3 of the IMD.

7. *How should the FCA be interacting with other domestic regulators? For example, the FCA's relationship with the Bank of England and Financial Ombudsman Service*

The FCA will need to maintain a close relationship with the Bank of England, FPC and the PRA particularly in view of its prudential oversight of a significant proportion of the financial services firms.

We welcome the strengthening of communication between the ombudsman and FCA and the statutory MoU.

We welcome the Government's proposals on consumer redress and agree with the Government that the ombudsman service should be able to focus on processing individual complaints on a case by case basis rather than having to deal with mass issues. We agree that the FCA should be ultimately responsible for determining which issues will be deemed to be causing mass detriment and making this public.

However we believe that there will be some cases that do not fall within the definition of mass detriment but will still require regulatory or legal clarification. We believe that there should be a clear, transparent and fair process for dealing with these complaints and this may mean building on the recently established ombudsman, FSA and OFT co-ordination committee. It is essential that the ombudsman is held accountable for its decisions particularly where there does not appear to be a consistency of approach.

8. *How should the FCA be interacting with international regulators? Do EU regulation initiatives restrict or enhance the work of the FCA? Will the FCA be able effectively to engage with the EU supervisory authorities?*

The proposed UK architecture does not appear to align to the new European Supervisory Authorities structure. These authorities have been established based on sectors rather than on function, for example, prudential and conduct. It is essential that the UK Regulators continue to influence and guide the setting of EU rules. It is therefore essential that UK representatives on the ESAs have a high degree of technical skill as well as the skills necessary to influence as appropriate. In particular we remain concerned that insurance firms may not be appropriately represented on EIOPA, due to the PRA's potential banking focus.

We note the proposals regarding international coordination and the MoU between the new regulators. However, the regulators must ensure that as it focuses on establishing its new domestic regulatory approach, any EU and global regulatory changes are not overlooked.

We have previously commented in response to the Government's earlier consultation papers that there is a need for a central international division to represent the UK on the new EU supervisory committees and other international fora. This international division could also ensure that the existing memorandum of understanding currently between the FSA and other international regulatory bodies continues with the appropriate new regulator.

We are concerned that some of the proposed conduct regulation powers set out in the draft legislation go beyond EU directives. It is essential that domestic law does not go beyond EU law and therefore the Government should provide clarity about the compatibility of the proposed powers with EU legislation.

The FSA's FCA's Approach to Regulation paper only briefly looked at the way the FCA will operate within the EU. However we are concerned that the paper implies some resistance to further harmonisation of conduct regulation and that the FCA will "tailor regulation" to the UK market. As London and the UK plays a central role in the global financial markets we feel it is imperative that any regulatory change considers the international competitiveness of the UK financial services market.

October 2011

Written evidence submitted by AEGON UK

About AEGON

AEGON is one of the UK's leading providers of pensions, life insurance, investments and annuities**.** We also own two large national distribution businesses, Origen and Positive Solutions.

With headquarters in Edinburgh, AEGON employs approximately 3,500 people in the UK and helps around two million customers to secure their long-term financial futures.

We're part of the AEGON Group, one of the world's largest financial services organisations, with a presence in more than 20 countries.

Are the objectives of the Financial Conduct Authority (FCA) clear and appropriate?

We are not wholly convinced that the combination of a strategic objective, several operational objectives, and a wide range of regulatory principles and "have regards", lends itself to clarity in the minds of regulators, firms or consumers as to how these ought to be prioritised and applied in practice, especially on those occasions where they are—or appear to be—in conflict with one another.

The FSA's recent paper, outlining the FCA's future approach, seeks to provide further clarification. We look forward to discussing this further with "shadow" FCA officials as they continue to develop their approach.

Should the FCA have a primary duty to promote competition as recommended by the Treasury Select Committee and Independent Commission on Banking? How should this work in practice?

Promoting effective competition will be an important part of the FCA's role. However, we agree with the Government's view that the duty to promote competition does not necessarily need to take primacy over other objectives.

Does the FCA's approach to regulation, as outlined in the Financial Services Authority (FSA)'s June 2011 document, represent an improvement on that of the FSA?

Developing a new approach is clearly "work in progress" and one which will necessarily continue to be shaped once the FCA is fully operational. There is much in the document which can only be properly assessed when there is more information on which to base such an assessment and experience of how a new approach works in practice.

The FSA's document acknowledges that regulators cannot entirely eliminate conduct risk and detriment arising from misconduct. Given this is the case, regulators should be wary of building up expectations for the new approach. Regulators have rightly said that isolated instances of misconduct should not be taken as showing the approach has failed. Equally, these isolated instances should not be interpreted as thematic problems requiring cross-industry solutions when in reality they are particular to a small number of firms or individuals within them.

The document refers to "a considerable investment in resources" (para. 1.10, p.6) required to deliver the new approach. We believe there is a need for greater transparency as to the scale of this extra resource. This should include periodic review of the appropriate resource needed to respond to the level of risk. There remains an onus on regulators to demonstrate that their approach is effective, proportionate and justifies the resources committed to delivering it.

We hope greater clarity will emerge as to how the proposed "differentiated approach" will operate in practice and on what basis sectors, firms, products and consumers will be differentiated. We accept, for example, that, given the wide definition of consumers in the draft legislation, regulators will need to treat different groups of consumers differently for some purposes. While regulators' judgment will play a part in this, we believe they should attempt to do this on a consistent basis rather than simply "as the mood takes them" or in response to external exigencies.

To whom should the FCA be accountable? Are the lines of accountability clear?

There is inevitably a tension between the concept of independent regulation and the ability of Ministers and Parliament to hold regulators to account. Broadly we believe the arrangements set out in the draft Bill are appropriate.

While regulators should not be accountable to the industry they regulate, it is important that firms and individuals have a realistic opportunity to appeal and seek redress—the more so in a more judgment-based regulatory environment.

Are the powers of the FCA suitable? Will their exercise be subject to appropriate scrutiny? How should the FCA be interacting with industry as well as using its intervention powers?

It is clearly right that regulators should have an appropriate suite of powers to enable them to meet their statutory duties and objectives and to fulfil their role effectively. We believe it is just as important, however, that these powers are themselves used effectively by regulators. Many of the aims set out for the FCA could be achieved by better use of the tools already developed by the FSA. In particular we believe the FCA could make better use of the Regulatory Conduct Risk Outlook (RCRO), as indicated below.

We have some comments on the specific powers proposed for the FCA:

— *Product intervention*
We have responded separately to the FSA's consultation on how it will use its product intervention powers. In that response, we expressed our belief that the FCA could achieve many of the intentions behind this by extending the concept of the RCRO and suggested that it might move from an annual report to a more dynamic communications medium, with a specific element of consultation with industry. Such interaction would help to obviate formal intervention.

— *Financial promotions*
We support the principle of transparency around the FCA's powers relating to prevention of misleading financial promotions and welcome the safeguards outlined in the White Paper around the publication of enforcement action. However, we remain concerned that publication may become a default mechanism. We believe that each case should be considered on its merits against a set of agreed criteria, which should include the impact on consumer trust and confidence.

— *Early publication of disciplinary action*
Likewise, it is important there are adequate safeguards around the publication of warning notices. Firms and individuals need to be held to account but it would run counter to the FCA's strategic objective of promoting confidence in financial markets, if consumers' trust was unnecessarily undermined.

How will the break-up of the FSA work in practice? Issues of coordination and information sharing between the FCA and the Prudential Regulation Authority (PRA)

Ultimately, effective co-ordination between regulators will depend as much on regulators themselves as on the formal mechanisms put in place to promote that co-ordination.

It will be important that the PRA and FCA co-ordinate their activities to ensure that dual-regulated firms do not experience a more (or unjustifiably less) onerous regime than those which are solely FCA-regulated, or that differences are kept to an absolute minimum.

We have ongoing concerns that the processes around authorisation and approvals for dual-regulated firms will prove unnecessarily burdensome. We will be expecting further clarification from regulators as to how they envisage these processes working.

There is a particular concern that firms which would "normally" be regulated exclusively by the FCA, but which form part of larger groups which are PRA-regulated, will be treated differently from similar "stand-alone" firms.

We are also unclear as to how the power for the FCA to designate Significant Influence Functions independently of the PRA will work in practice.

Under the provisions of the draft Bill, the PRA and the FCA will be required to draw up a Memorandum of Understanding (MoU) and to review this on an annual basis. The Bill does not provide for a formal consultation process around this. In our response to the Government on the draft Bill, and our submission to the Joint Committee charged with pre-legislative scrutiny, we have argued that there should be a formal mechanism to ensure the FCA and PRA consult with practitioners and, where appropriate, consumers, possibly through the relevant Panels. Regardless of whether the Government takes this suggestion on board, we would urge the FCA to consider how they will consult on the MoU.

How should the FCA be interacting with other domestic regulators? For example, the FCA's relationship with the Bank of England and Financial Ombudsman Service

We agree with the Government that the Financial Ombudsman Service (FOS) could potentially act as a bellwether to highlight particular issues which were causing consumer detriment "spikes"—but that it should then be the clear responsibility of the FCA to take forward dealing with those issues.

We believe the relationship between the FCA, as conduct regulator, and the FOS, as complaints handler, could be put on a much more effective footing than at present and this is one way in which it could be improved.

How should the FCA be interacting with international regulators? Do EU regulation initiatives restrict or enhance the work of the FCA? Will the FCA be able effectively to engage with the EU supervisory authorities?

In our responses to the Government, both on the draft Bill and earlier consultations, we have specifically highlighted this issue and argued that the new regulators should have a more explicit responsibility for ensuring UK interests are protected and advanced in Europe. Clearly, a cross-sectoral "twin peaks" approach does not sit entirely comfortably with the regulatory structure adopted by the EU, with integrated sectoral regulators. It will be a challenge to ensure that UK representatives have all the necessary knowledge and skills required to negotiate successfully with European counterparts.

We believe the UK regulators should also take on greater responsibility for communicating international (and especially EU) regulatory developments to the UK industry and, where appropriate, to consumer groups. Having early sight of where international regulatory requirements are headed will enable individual businesses to prepare better for eventual implementation and will also enable them to give UK regulators the feedback and evidence they need to support their contributions on the international stage. This will help ensure that the UK's interests are accurately represented in discussions and negotiations with other regulators in Europe and beyond.

October 2011

Written evidence submitted by Brewin Dolphin, Cazenove Capital Management and Rathbones

Executive Summary

1. We are the three leading firms which provide complete wealth management services in the UK. As such our day to day businesses will primarily be subject to Financial Conduct Authority (FCA) supervision (although Rathbones has a banking licence so will be lead regulated by the Prudential Regulatory Authority (PRA)).

2. We currently provide services for over 200,000 individual clients, charities and pension funds. We can all trace our ancestry to the eighteenth century during which time we have acquired a reputation for trust and probity for private investors. Between us we have £57 billion under management and 58 offices around the UK, Ireland and the Channel Islands.

3. In recent years, the cost and complexity of regulation and red tape has increased substantially. It now represents around 5% of our turnovers excluding the FSCS levies of £12.3 million we paid between us this year, due to failures in other parts of the industry and we would argue not identified early enough by Regulators. These significant costs are increasingly pricing our services out of the reach of small investors. Our mantra used to be—"never too small to start saving and investing"—in reality the barest minimum investment for the services and investment advice we provide is now well over £100,000.

4. The current reform of the regulatory architecture, including the creation of the FCA, provides a "once in a generation opportunity" to ensure the regulatory system in the UK is fully fit for purpose. We believe the FCA can help achieve this goal by working more closely with the industry to prevent the problems of the past—which have resulted in compensation payments in total of over £15 billion and a catastrophic loss of confidence in the whole financial system. Unfortunately, we still have significant concerns that the existing proposals miss this opportunity and that there is a risk that the creation of the FCA will result in less not more effective regulation for private investors.

5. The FSA should be exploring a different approach to investor protection which could help achieve a greater level of confidence and certainty for the majority of consumers with a suite of simplified products which will "do what they say on the tin" and be underpinned by more stringent rules and costs caps. The Financial Services Consumer Panel[12] is conducting research along this theme and we believe such an approach would deliver better protection for the most needy and if deployed in combination with prudent product intervention and better use of intelligence gathering from the market, would represent the route to enhanced regulation in the UK. We are developing ideas around such a model and would welcome the opportunity to start a dialogue on how these might be implemented within the new regime.

6. Ultimately, it is in all our interests—that is the government; regulators; consumers and regulated firms—to have a strong and well regulated financial services industry. Firms and regulators are mutually responsible

[12] http://www.fs-cp.org.uk/publications/pdf/straightforward_outcome.pdf

for the future of the industry's reputation; the nation's savings and for paying compensation when things go wrong.

Are the objectives of the Financial Conduct Authority (FCA) clear and appropriate?

7. We have a number of concerns; in particular, the FCA is proposing to employ a definition of the term "consumer" which fails to distinguish between retail and professional consumers of financial services. The word consumer has a clear meaning which the legislation is distorting; general consumers of basic financial services may require higher levels of protection than more sophisticated investors or wholesale market participants. The definition does not address the "various levels of knowledge and sophistication", as we believed was the Government's intention.

8. It also confuses the definitions established by the EU's MiFID legislation—ie Retail; Professional and Counterparty. There is a danger that the very broad use of the term to encompass wholesale market funds as well as individual investors will accelerate the tendency towards one-size-fits all approach to regulation. In addition, the definitions fail to define the role of Trustees and Local Authorities, a specific issue being addressed in MiFID2.

9. We are also disappointed that the FCA has not indicated how it intends to pursue the principle that consumers are ultimately responsible for looking after their own interests and the choices they make, as outlined in HMT's New Approach to Regulation published in February 2011 (See Regulatory Principles 4.26 p64). We recognise that the bewildering array and complexity of so many financial products makes regulators nervous and keen to seek to protect investors. But we believe that without some significant changes to the proposals it will be impossible to achieve the correct balance between regulatory intervention to protect investors and the principle that consumers must take ultimate responsibility for their actions.

10. We believe that this tension can be resolved by more carefully demarcating the boundaries between core financial products, where consumers require the highest level of protection and more sophisticated offerings which should remain available via regulated advisers. Enhanced protection and more stringent rules based regulation should cover a suite of basic financial products and the majority of consumers. As it stands, the proposed approach to regulation, risks making the cost of advice prohibitively expensive, and the growing "Advice Gap" will continue to widen leaving a deepening social problem among middle income earners, who with good financial advice throughout life should be able to support themselves well into their old age and not a burden on the state.

Should the FCA have a primary duty to promote competition as recommended by the Treasury Select Committee and Independent Commission on Banking? How should this work in practice?

11. Financial Services is a competitive industry and should not need regulatory help to encourage competition. The FCA should prevent anti-competitive restrictions, including barriers to entry and high regulatory costs which are particularly burdensome for small firms. While at the other end of the scale greater co-operation with the EC is necessary to ensure unfair advantages are not accrued by EU firms "passporting" into the UK (see our answer to Q 8).

12. It will be hard for the FCA to strike the right balance between its competition mandate and its product intervention powers. Having said this, we welcome the use of product intervention powers where a product does not "do what it says on the tin"—or is not suitable for a form of distribution eg sold within an ISA when not ISA compliant. On past experience the FCA will need industry expertise to identify these dangers. We have previously suggested seconding product analysts to an FCA committee to scrutinise products which have raised concerns.

Does the FCA's approach to regulation, as outlined in the Financial Services Authority (FSA)'s June 2011 document, represent an improvement on that of the FSA?

13. No. Indeed, there is a risk that the private investor in the UK will be subject to less effective regulation and many consumers will no longer be able to afford advisory services at all.

14. Nor do we believe that there has been sufficient effort to identify accurately where and why past failures have occurred; why certain existing powers were not used, or to produce a set of proposals that explicitly address recognised failures. Instead, it seems that the interpretation by the FSA of the Treasury's proposed principle, are tending towards a rather aggressive, one size fits all structure that will replace face to face regulation with call centres and an academic and mechanical approach. We think this is unlikely to offer an improvement on the status quo or better outcomes for investors.

15. The FCA should be adopting a different approach—in particular, it should be working more closely with firms, not distancing itself from them (which a call centre will do). The move away from relationship management is of significant concern to us, as the strength of and trust in the relationship with supervisors has been hugely beneficial to both firms and the regulator in the past. In addition, will not be possible for the FCA to be proactive and interventionist if it does not fully understand the firms that it is supervising. The regulator needs to be as well informed as firms and contact is the best source of market intelligence. FSMA 2000 already

gives the FSA considerable powers which include the appointment of skilled persons (s.166) and the ability to request any information deemed necessary for the discharge of their regulatory duties (S.165).

16. The new proposals point to even more reliance on the use of contact centres—similar to the supervision of "small firms" by the FSA. This consists of a firm contact call centre and base line monitoring (the returns are not reviewed manually but only looked at if a system alert is generated because there is too great a difference for one or more entries). Finally, this is supported by "thematic" reviews of firms by the supervisors—there is no detailed, regular, review and this will be the same for all non-relationship managed firms in the FCA.

17. We strongly question the effectiveness of this model which has previously failed in cases such as Keydata. We also fear that firms will be less likely to conduct an open relationship with the Regulator under this regime and that it is likely to lead to lower calibre individuals being involved in regulation.

18. In addition, the FCA intends to make greater use of business analysis to help guide its approach to regulation. We do not believe that desk based analysis is an adequate substitute for good quality relationship management and "face to face" time spent talking to both practitioners and investors. Business analysis is likely to be academic, and generally disconnected from the practical issues concerning firms and consumers.

To whom should the FCA be accountable? Are the lines of accountability clear?

19 No. We would prefer the FCA's accountability to the Treasury to be set down in greater detail. In addition, we would favour a greater degree of accountability to the Treasury Select Committee. The FSA's high handed treatment of the TSC's valuable work on RDR and the content of their June 2011 "Approach for the FCA" document, with minimal consultation or justification for the new structure, do not bode well in this regard. Let us not forget that the FSA has to share in the blame for the crisis of confidence in the Financial Services Industry. The examples of Northern Rock and RBS show that the FSA has not always followed the same high standards it expects of firms.

20 The FCA should also be accountable to the industry it regulates. This should take the form of a comprehensive quarterly or annual report which would detail the FCA's costs; identification and scale of risk, as well as successes and failures during the period. This information should be shared with the TSC, FPC and the PRA.

Are the powers of the FCA suitable? Will their exercise be subject to appropriate scrutiny? How should the FCA be interacting with industry as well as using its intervention powers?

21. The FCA's proposed approach to enforcement is of significant concern. Under the new regime, the FCA will publish the fact that a warning notice in respect of enforcement action has been issued (ie before an enforcement investigation has been proven).The FCA will be able "to disclose the fact that a warning notice in relation to a *proposed disciplinary action* has been issued" (Blueprint for Reform, paragraph 2.106). This is provided for in the Draft Bill Sch 8, p 24, amending s 391 FSMA.

22. This approach has four major problems. First, it will act as a strong disincentive for firms to engage with the FCA, forcing the FCA and firms even further apart. Why would a firm call the FCA contact centre to discuss an issue (in the knowledge that there is a strong chance that the FCA staff member will not understand the firm, its sector and the context) given that there is a higher likelihood of being referred to enforcement and the issuance of a public statement prior to an investigation?

23. Second, the publication of these notices will have significant commercial implications for firms and there customers and we therefore consider it unfair that issues behind the notice are not fully investigated and fairly considered prior to publication. It is particularly dangerous where the firm is publically quoted and could lead to a false market in the company's shares, as happened to Gartmore in 2010 when its shares fell by 30% on the day FSA announced their investigation into Guillaume Rambourg and clients withdrew £1.1 billion from Gartmore funds A year later all allegations were dropped but by then the damage was done and a terminal decline had set in at Gartmore.

24. Third, the publication of a warning notice has the potential to mislead consumers and result in consumer detriment. For example, consumers may respond to the publication of a notice by exiting a firm's product or service at a loss or not subscribing, yet a full investigation may show that no issues exist.

25. Fourth, it will be interpreted by the outside world that the FCA already thinks the firm is guilty and they will be acting as investigator, judge and jury. This contravenes the concept of natural justice and will therefore be open to challenge by judicial review.

26. A regulator needs strong and fair enforcement capability and the FSA's credible deterrent enforcement strategy works in its current form when properly applied. The regulator already has the tools to intervene quickly on time critical matters.

27. Rather than publishing enforcement notices, which are anti competitive and replete with the dangers outlined above, the regulatory authorities could employ their existing powers to require enhanced capital adequacy "buffers", provided for within the ICAAP rules. When these are coupled with the threat to a firm's

reputation with publication of an enforcement notice, they should act as a restraint on firms and ensure fast resolution of whatever issue. The FSA has been known to use their other power in this area and to send out Asset Retention Letters, which require firms to inform them before they do anything to their capital structure, when it is concerned that a firm may not meet potential liabilities.

28. There is a strong degree of mutual responsibility—firms have as much interest as the Government and the FCA in getting it right this time. Firms and regulators are mutually responsible for the future of the industry's reputation; the nation's savings and for paying compensation when things go wrong.

See our comments about product intervention above at Question 2.

How will the break-up of the FSA work in practice? Issues of coordination and information sharing between the FCA and the Prudential Regulation Authority (PRA)

29. We have concerns about cost control at present within the FSA and fear that the focus is too much on reorganisation rather than effective regulation and restructuring, which risks further regulatory failure. There is some evidence that the best staff are leaving the FSA[13] to join the private sector and that some joining the PRA leaving the FCA with the "rump".

30. While our comments at Q.7 below about reporting and information sharing are important to avoid regulatory failure and preserve the industry's reputation, firms regulated by both the PRA and the FCA will have a special interest in efficient information sharing—to avoid overlap, misunderstandings and increased costs.

31. It will be important for firms to be consulted on the Memorandum of Understanding which is due to be produced by the PRA and the FCA.

How should the FCA be interacting with other domestic regulators? For example, the FCA's relationship with the Bank of England and Financial Ombudsman Service

32. The FCA should have the same relationship and responsibility to the FPC as the PRA, both for its own status as well as accountability. There is some evidence of tensions already between the two bodies, with some staff in the old FSA, feeling or being considered inferior. We believe this is a strong argument for the FCA's equal status under the FPC. Credibility and confidence in the industry is as much at stake from actions [or their lack] by the FCA, so we argue that significant strategic decisions should also be scrutinised and ratified by the FPC.

33. Regarding the FCA relationships with the FOS, the FSCS and the Money Advice Service (MAS) they need to be redefined and published. We need clarity of ownership/responsibility for each of them—all of which are funded through levies on our industry, but again without apparent accountability.

34. For example—the Money Advice Service (MAS), which is intended to fill the Advice Gap we are so concerned about, raises the following questions:

(1) FSA claims it is no longer responsible for the management of the MAS—yet it does levy £43.7 million from the industry to pay for it. Who is responsible? The website claims MAS is answerable to the FSA.

(2) Website is impressive and contains lots of information—however—some is inaccurate and demonstrates a worrying lack of knowledge eg you can lose more than you invest in an Investment Trust (due to gearing facility).This is simply wrong! Is the FSA responsible for the content?

(3) The face to face "advice" service has six staff in London—how could sufficient advisers be deployed around the country within the £43.7 million budget? How is the budget split between the website, call centre and advisers?

(4) The MAS advisers we have spoken to freely admit that the majority of queries from the public are debt related.

(5) MAS advertising claims that its advice is independent, unbiased, trustworthy and free—this implies that MAS provides free qualified financial advice and that advice provided by the industry is biased and expensive. Our understanding is that MAS only offers information and guidance from unqualified advisers on how to find more information.

How should the FCA be interacting with international regulators? Do EU regulation initiatives restrict or enhance the work of the FCA? Will the FCA be able effectively to engage with the EU supervisory authorities?

35. The British private investor (retail) business model is much misunderstood within the EU—differing as it does so fundamentally from the bank driven models on the continent. We all, including the regulators when negotiating on our behalf, need to make a much greater case for the benefits of independent advice and direct access to markets for private investors as exists in the UK.

[13] Including Managing Directors of Retail and Wholesale (John Payne and Sally Dewer who left earlier this year. In addition the HR director, COO, director of banking sector, director of insurance sector, director of financial stability we believe have all left in the last 18 months.

36. At the same time, the FCA needs to adopt a more pragmatic approach to EU legislation and seek to better coordinate its own initiatives with what is in the EU pipelines. For example, PRIPs, the EC initiative to develop a common level of consumer protection for retail packaged products is due for EU wide implementation soon after our RDR. The scope of this MiFID subsidiary is broadly similar to the RDR covering the same product range; transparency of charges and inducements; selling practices including advice and conflicts of interest; product disclosure and Key Investor Information (KIID)—but not including professionalism and qualifications.

37. The expectation of PRIPs introduction not long after the RDR , highlights the front running by the FSA and reasons for our call for the RDR process and costs to be reviewed and for the good principles of professionalism and transparency to be introduced at the same time as PRIPs under the new FCA Regulatory Structure. This call for delay, as is widely known, has found no support at the FSA.

38. An argument that whatever new proposals the FCA intends, they should at the very least agree principles and timetables with the EC. There is an overarching need to decide whether our industry should be subject to EU or local financial regulation, as presently every which way present arrangements are too costly and anti competitive.

October 2011

Written evidence submitted by the CBI

Executive Summary

- The FCA's objectives and principles should encompass the need to maintain the industry's competitiveness as well as competition, and should recognise the unintended consequences of disclosure.
- The FCA's competition duties need to be aligned with its overall regulatory objectives.
- The success of FCA's regulatory approach will depend on the quality of the staff people it employs and how it utilises its resources.
- The FCA must be more accountable to firms it regulates, in addition to its broader public accountability.
- Stronger controls are needed over the FCA's product intervention and early disclosure powers.
- Coordination between the FCA and PRA should be achieved through a combination of legislative underpinning, a strong Memorandum of Understanding, operational arrangements and a culture of engagement.
- The Government should conduct an independent review of the proposed governance arrangements of the financial regulators, and take the opportunity to reform the work of the Financial Ombudsman Service.
- Effective international coordination must be a priority and the Government should legislate to establish and executive level International Coordination Committee.

The FCA's objectives and principles should encompass the need to maintain the industry's competitiveness as well as competition, and should recognise the unintended consequences of disclosure…

1. The FCA's objectives and principles of regulation are, on balance, clear but there are some significant changes that need to be made so that the FCA can supervise its firms in a way that is appropriate.

The objectives that are proposed currently do not reflect the need to maintain the competitiveness of the UK and its financial sector…

2. While stability, fairness and a strong regulator are all features of a globally competitive financial sector, a regulator that does not need to consider competitiveness might produce regulation that promotes stability or good conduct but damages market competitiveness. The FCA should be required to consider the competitiveness of the UK when taking regulatory decisions, although it should, of course, be secondary to the need for strong conduct of business regulation.

3. If this is not included as a regulatory objective in its own right, it is important that it is included as a regulatory principle for the FCA.

4. This would be consistent with the objectives and principles of other overseas regulatory bodies.

The FCA should recognise the unintended consequences of disclosure…

5. The FCA's transparency Principle is intended to promote a greater level of openness and disclosure by the regulator. Although in some limited cases publishing information relating to firms can help customers and help the regulators to achieve their objectives, there should be a presumption of non-disclosure unless clear and precise reasons can be given for disclosing such information.

The regulatory principles should reflect the competition objective…

6. An additional principle should be added, mirroring the FCA's competition operational objective, requiring the FCA to consider when developing new rules or taking regulatory actions whether there is a solution that uses competition mechanisms to achieve the same objective (see question 2).

The FCA needs to articulate how it will implement the Consumer Responsibility principle…

7. We welcome the Principle that consumers should take responsibility for their decisions. This is an important concept but, of course, it needs to be implemented effectively in practice. The FCA needs to do more than the FSA has done in the past to explain to consumers their responsibilities, and it will need to consider the principle when taking regulatory decisions and developing policy.

The definition of Consumer should build in a presumption of proportionality…

8. The proposed definition of "consumer" is wide and ranges from retail customers through to sophisticated wholesale investors. "Consumer" should be defined carefully so that it builds in an automatic presumption of proportionality depending on the size and nature of the customer and the nature of the product or services being provided to them.

The FCA's competition duties need to be aligned with its overall regulatory objectives…

9. We support the inclusion of competition as part of the general duties of the FCA. Competition should be used as an effective tool to improve consumer outcomes, particularly where issues arise across market sectors rather than at individual firms. However, there are some areas where the competition objective could in fact reduce the stability of the financial sector, for example when dealing with market infrastructure.

10. The objective should be explicit that the focus on competition to achieve regulatory outcomes does not mean that the FCA should consider competition in respect of issues outside its overall objectives. It should clearly constrain the FCA from, for example, interpreting its operational objectives in a way that leads it to attempt to regulate prices or become an economic regulator.

The success of FCA's regulatory approach will depend on the quality of the staff people it employs and how it utilises its resources…

11. Perhaps the most important issue to consider when looking at whether the FCA's proposed approach is an improvement on the FSA's is how it will be able to apply it in practice.

12. For the regulator to operate effectively it must employ supervisors of sufficient knowledge and experience to build credibility with regulated firms. The FCA needs to publish practical plans that explain how this will be achieved so that consumers and regulated firms can have confidence in its ability to supervise the industry.

13. The regulatory approach should be based on assessments of the risk that regulated firms' pose to the FCA's objectives and mean more than just the size of total assets. The FCA has indicated that the assessment will depend on the size of "incidence", based on numbers of consumers, and its "severity". This more sensitive approach is to be welcomed if it results in a regulatory approach that more closely reflects the risk and impact of the firms it supervises.

14. The authorities should also take the opportunity presented by the change in the regulatory framework to actively consider where and how resources are best spent to prevent cost increases in areas where regulatory risks are lower. This will benefit both authorised firms and consumers, who ultimately bear the costs of regulation.

The FCA must be more accountable to firms it regulates, in addition to its broader public accountability…

15. We support the proposals for accountability that are set out in the Government's White Paper, but we believe an independent review of the governance arrangements is needed to build confidence in who is in charge.

16. The FCA, however, should be more accountable to the firms that it regulates. Firms will frequently challenge decisions informally, and this discussion and debate will help achieve the best regulatory outcomes. Formal challenges to decisions or processes to hold the regulator to account should occur far less frequently, and the bar for their use should necessarily be set high. But they are needed to hold the regulator to account for its actions. It is therefore important that the the Upper Tribunal which should have the power to pass directions to the FCA, rather than just ask it to reconsider issues.

17. For this challenge process to be effective, a clear standard against which regulators can be judged must be set. This standard, and the legislation that underpins it, should be based on a test of "reasonableness". This would mean that the regulators would need to defend their actions on the basis that they were reasonable given the information they had access to and the rules that were in place at the time.

Stronger controls are needed over the FCA's product intervention and early disclosure powers…

18. The FCA will be given tools to help it take forward its more proactive approach to customer protection. These tools and the controls and scrutiny over how they are exercised need to be tightened.

There might in theory be circumstances in which product regulation could be effective if used selectively, but they would be extremely limited…

19. The FCA should instead focus on product governance and compliance throughout the product life cycle. This would include the process of designing new products; financial promotions and marketing; the sales process; and customer satisfaction and complaints monitoring.

20. Product regulation powers otherwise have the potential to reduce the availability and variety of products for consumers as firms become less likely to invest in developing innovative products or believe they will be penalised or restricted from developing products which do not align with criteria imposed by the regulator.

21. The FCA should engage with industry to consider:

- The FCA's proposed risk appetite and the criteria that must be met before the tool is used—powers may only be used when no alternatives can be reasonably assumed to work.
- The cost benefit analyses that should be undertaken before the powers are used.
- The length of notice that will be adequate to give in advance of requiring a firm to amend or withdraw a product.
- The appeals mechanisms so that firms or groups can challenge the regulator's judgements quickly and receive an independent hearing.

Product intervention is unlikely to be relevant to wholesale markets…

22. We are pleased that the new product intervention power is unlikely to be used in respect professional or wholesale customers, and that the FCA may not use its new product intervention power to advance the market integrity objective without HMT direction. It is not clear, however, when this power of direction would be used.

23. The FCA will need to be careful if it "reaches up the distribution chain" to apply the use of the tool to wholesale firms.

Early disclosure of disciplinary actions can be a very damaging tool if used in the wrong way…

24. We are wary that the early disclosure power could have a severe effect on a firm or individual against which it was used, both immediately as the warning damaged its strategy and over the longer term as its reputation is affected. Even if a "notice of discontinuation" was issued, it is unlikely that this would repair any damage that had been caused as it is likely to be misinterpreted by consumers, the media and market participants.

25. We support the safeguards that are being placed on the power but further protections are required. There must be an effective independent appeal process that can be applied in advance of publication.

26. There must also be a process that firms can use after the publication to hold the FCA to account. This would form an essential to ensure that this power was used only when it was reasonable and when no other measure would achieve the regulatory objectives.

Coordination between the FCA and PRA should be achieved through a combination of legislative underpinning, a strong MoU, operational arrangements and a culture of engagement…

Firms need certainty around the prudential supervisors…

27. It is essential that firms have certainty about who their prudential supervisor will be over time and that firms are, where possible, supervised with their peer group. There is otherwise a risk that the regulatory structure could favour one firm over another or act as a barrier to entry to certain markets or business models.

28. We agree that the practical arrangements for dividing responsibility for prudential supervision of investment firms between the regulators is an operational issue but it should be developed within a legislative framework of procedural safeguards and clear and transparent principles. Legislators need to do more to define this split.

Differences in the FCA and PRA's objectives and approach should not lead to a two tier prudential regime…

29. The PRA and the FCA have different sets of objectives—whereas the PRA must contribute to the stability of the UK financial system, FCA must protect and enhance confidence in it; the PRA must promote the safety and soundness of PRA authorised persons, whereas the FCA must secure an appropriate degree of protection for consumers.

30. These differing objectives give rise to the potential for differences in their approach to prudential supervision. This may damage competition between firms that are close to the dividing line between being supervised by the FCA or PRA and could even be peers.

31. Differences in objectives and approach must not lead to a two tier regulatory regime for firms within the same industry.

Asset managers should not be supervised on a "going concern" basis…

32. The FCA will supervise the majority of its firms on a "gone concern" basis, from a prudential perspective. However, it will aim to supervise some larger firms on a "going concern" basis, for example large asset managers and investment firms that deal as principle.

33. There is, however, a large difference between these two approaches and size is not necessarily a good indicator of the risk that a given firm will pose to the FCA's objectives. There may be an argument for extending the "going concern" approach to investment firms that deal as principle but it should not be extended to even large asset managers.

Using a single point of contact or shared functions will promote coordination, clarity and efficiency…

34. The potential for duplication or underlap between the regulators is clear. This is most obvious in an administrative sense—for example duplicate supervisory visits or reviews; or requests for similar but different information. But it could also arise in a more general regulatory sense, for example, the two regulators could introduce conflicting rules or take regulatory actions to address risks which arise in respect of a certain service or product.

35. Using a single channel or point of contact would be one way of improving efficiencies and coordination.

36. Combining operational functions would also help manage coordination as well as improving efficiencies. Shared services arrangements can either be outsourced from one firm to the other or can be established in a third entity and would result in cost efficiencies but would also simplify their operational arrangements, firm interaction and transfers of staff between the organisations.

37. Although the regulators will need to exercise operational independence, this will help ensure a practical minimum of duplication, and promote consistency in the data required from firms.

Maintaining a single rule book will reduce complexity and help encourage compliance…

38. The approach to rule making and supervision will differ between the two regulators, but from a practical perspective combining the rules within a single Handbook, as is currently the case with the FSA, will make it simpler for firms to apply. An overcomplicated structure of rules will increase the chances that firms, particularly smaller firms, are not compliant, as well as increasing the overall cost of regulation.

An efficient authorisation process is fundamental to supporting the competition objective…

39. We are pleased that the Government has decided to adopt the "alternative approach". Given the FCA's competition objective, it is important that the authorisation process, and the process for cancelling permissions, is made as efficient as possible.

Regulatory fees will need to reflect the new approach, and the risks that individual firms pose…

40. The impact assessment included in the recent HMT publication confirms that the costs of establishing the new regulatory bodies will be substantial. Transition costs for dual-regulated firms will also be significant. But there has been little consideration of future fee increases will be managed. The FCA will need a clear position on the future cost of regulation and how the current proposals fit within this.

The Government should conduct an independent review of the proposed governance arrangements of the financial regulators, and take the opportunity to reform the work of the Financial Ombudsman Service…

An independent review of regulatory governance will build confidence in the new arrangements…

41. The Bank of England, the FPC, FCA and PRA sit within an overall regulatory governance framework. The Government should conduct an independent review of the proposed governance arrangements so that all stakeholders can be assured that the regulatory bodies are structured and interact in a way that is effective and accountable and free from conflicts.

The Financial Ombudsman Service (FOS) needs to refer important decisions to the FCA…

42. The FOS has an important role in ensuring that complaints against regulated firms are dealt with appropriately. But there are elements of its governance, working practices and powers that need reform, including its interaction with the FCA.

43. In the past, FOS has taken rulings on individual cases which have set a precedent for future complaints. This has raised concerns about the reasonableness of its judgements and compared with the expectations that the regulator had at the time that the issue arose.

44. Where the FOS takes decisions that are novel or are likely to set standards for wider groups of complaints or policy for regulated firms more generally, they should refer the decision to the FCA as the body which sets conduct of business standards. This will help ensure consistent treatment of consumers.

45. Similarly, where the FCA takes a decision on a specific industry issue, the FOS must follow that decision and must make its rulings in accordance with it, whether or not it arises from a referral from the FOS. The FOS should view complaints in the light of the conduct rules and guidance existing at the time that the issue arose.

Effective international coordination must be a priority and the Government should legislate to establish and executive level International Coordination Committee…

46. The majority of new regulation will be developed at a European or international level and supervision will need to sit within the framework of European regulators and colleges of national supervisors.

47. The Government should mandate the establishment of an executive level International Coordination Committee comprised of senior representatives of the PRA and FCA. The committee's mandate should, in our view, include:

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

This time of reform is also an opportunity to ensure that the UK's financial sector is fully engaged in the European regulatory process…

48. London is the leading European financial centre and the expertise found in the UK cannot be found elsewhere in Europe. It is therefore important that the UK has a commensurate level of influence at the European regulatory bodies and throughout the policy and legislation process.

49. The only way that this can be achieved is by establishing practical arrangements for the FCA at all levels to engage with ESMA and the European Commission. Not only will this help the UK contribute meaningfully to the debate as it arises, but it will also put those with practical expertise at the heart of the policy making process over the long term.

50. This must work well at a senior level, as they will shape today's debate, but it is also important to get more junior staff engaged as they will be influential over the longer term. Working closely with European counterparts and bodies will help the UK regulators develop the skills that they need to negotiate and influence in Europe.

51. The UK financial services industry would support proposals for engagement by the UK regulators in Europe, including secondments.

October 2011

Written evidence submitted by Nationwide Building Society

Nationwide Building Society welcomes the opportunity to provide written evidence to the Treasury Select Committee (TSC) as part of the inquiry into the Financial Conduct Authority (FCA).

Nationwide is the UK's third largest mortgage lender, third largest high street savings provider and sixth largest high street financial services organisation, with around £190 billion in assets. We are unique in retail financial services—a mass market mutual able to provide a viable and competitive alternative to the plc banks for consumers. Indeed, the Independent Commission on Banking identified Nationwide as the primary challenger brand in retail financial services. We are owned by and run for the benefit of our 15 million members. We are naturally consumer focused and, although we must take a commercial approach to remain competitive, we do not compromise our mutual principles.

Executive Summary

Nationwide Building Society broadly supports the remit of the FCA as outlined in the draft legislation. However, there are a number of important aspects we believe the Committee should take into consideration as it conducts its inquiry:

- Supervision and regulation must consider the risk posed by the investment activity of an individual institution, taking into account its business model.
- Improving consumer outcomes and increased competition should be a pivotal element of regulatory reform. The draft Bill strikes an appropriate stance, ensuring that competition is at the heart of the FCA's operational model. However, clear lines of responsibility need to be drawn between the FCA and the OFT to ensure any overlap on for example, pricing and competition policy, is reduced.
- We believe that effective competition occurs where consumers can easily compare products using clear and transparent sales literature, make informed choices and switch providers within a regulatory framework that provides a level playing field for firms, irrespective of their ownership structure.
- There needs to be a strong focus on regulatory co-ordination generally as the new structure is developed, particularly between FCA and PRA to avoid dual-regulated firms facing disproportionate costs.

Detailed responses to the specific questions raised by the Committee are provided below.

1. *Are the objectives of the Financial Conduct Authority (FCA) clear and appropriate?*

1.1 Nationwide Building Society supports the FCA's strategic objectives as set out in the draft legislation, which we hope will provide consumers with the degree of protection they require and promote greater choice within the market.

1.2 We are supportive of an approach an approach to regulation which is more proactive and engages early with firms. Ensuring consumers take responsibility for their own decisions is important; however this must not be used by financial services institutions as an excuse for misselling products.

1.3 We note the inclusion of new section 1C(2) in the draft legislation which places a duty on the FCA to have regard to any information which the scheme operator of the Financial Ombudsman Service (FOS) has provided to the FCA pursuant to new clause 232A (in considering what degree of protection for consumers may be appropriate, for the purposes of securing the FCA's consumer protection objective). We believe this is worthwhile in assisting not only the FCA but also firms in implementing a risk-based approach to product-related design and disclosure. We would however, welcome clarity on the means by which the FCA will judge the inherent risk of such products and the needs of consumers with differing levels of sophistication.

1.4 In any event, these factors have the potential to motivate firms to make sure consumers are given appropriate and accurate information at the right time so they are able to make an informed decision and secure the best outcome for them. Firms should then be confident that the FCA will asses their behaviour against the principle outlined in the draft legislation that consumers should take responsibility for their decisions.

2. *Should the FCA have a primary duty to promote competition as recommended by the Treasury Select Committee and Independent Commission on Banking? How should this work in practice?*

2.1 We believe that improving consumer outcomes should be a pivotal element of regulatory reform, and competition has a key role to play. In some areas of retail financial services, competition has not been as powerful a force as might have been expected. Payment Protection Insurance is perhaps the most obvious and current example.

2.2 Effective competition occurs where consumers can easily compare products using clear and transparent sales literature, make informed choices, and if appropriate, switch providers within a regulatory framework that provides a level playing field for firms irrespective of their ownership structure. A greater regulatory focus on competition has the potential to improve consumer outcomes and reduce the need for regulation.

2.3 We therefore welcome the plans to allow the FCA to exercise its powers in relation to competition. The draft Bill strikes an appropriate balance between ensuring that competition is at the heart of the FCA's operational model and ensuring that its remit does not cut across the existing competition law regime, which would lead only to uncertainty. Giving the FCA the power to make an advanced referral to a specialist competition regulator seems therefore to be an appropriate position.

3. *Does the FCA's approach to regulation, as outlined in the Financial Services Authority (FSA)'s June 2011 document, represent an improvement on that of the FSA?*

3.1 We are broadly supportive of supervisory initiatives such as more intrusive product intervention. However it is vital the FCA reflects the true risks imposed by individual firms and their business models—size does not necessarily equate to risk. For example building societies in general behaved responsibly during the housing boom but they have to pay disproportionately into the Financial Services Compensation Scheme (FSCS), providing support for those banks that were much less prudent. The FCA should aim for early, regular and productive dialogue with firms, ultimately aiming to develop co-operative relationships.

3.2 The FCA may adopt a different approach to that of the FSA. Marketing and sales may not be allowed to continue where the FSA has typically allowed this to happen, backed up by a remedial programme to rectify the consumer detriment. Whilst agreeing with the intent, Nationwide believes the FCA does not necessarily need further powers. Rather it should use existing powers which the FSA chooses not to use.

3.3 We broadly welcome the confirmation, as stated in the July 2011 document, that the FCA's culture will be one of transparency. The document indicates the FCA will build on the FSA's approach to consultation as part of the rule-making process, seeking to develop more effective ways of getting feedback on proposals including from consumers and their representatives.

3.4 Whilst this a welcome move, it will only be worthwhile if any feedback received is properly assessed and taken into account in a balanced manner as new rules are developed. There have been occasional instances of this not being the case in the past. For example, in relation to the Mortgage Market Review. The industry highlighted a significant number of issues with the proposals made. The FSA eventually deferred the publication of documents in order to reconsider and conduct further analysis, however communication in between these two events should have been better. We are keen to avoid situations of this nature occurring under the FCA. The key is to have a balanced consideration of the risks but also close liaison with the Treasury and other bodies to ensure the outcomes meet the wider requirements.

3.5 As far as disclosures are concerned, we would highlight that there must also be full recognition of factors such as commercial activity and competitive positioning before any such disclosures are made.

4. *To whom should the FCA be accountable? Are the lines of accountability clear?*

4.1 Nationwide believes the TSC should scrutinise the Chancellor's appointments to the Boards of both regulators. The TSC has a veto on the appointment of, for example, the Chair of the Office of Budget Responsibility, but an equivalent check does not appear to have been suggested in respect of the regulators.

4.2 Accountability in the event of regulatory failure is extremely important. The obligation to report to HM Treasury should a regulatory failure occur, addressing actions and lessons learned only, goes part-way to solving a problem. For example, the FSA was found wanting in its supervision of Northern Rock but the industry ended up paying for it via the FSCS. Indeed the mutual sector—which, broadly, behaved responsibility during the previous decade—has paid a disproportionate amount for the failure of plc banks, to the sum of £366 million over the last three years.

4.3 HM Treasury should be obliged to lay before Parliament any report it receives, consistent with its obligation set out in the new section 3E(6) in relation to the Memorandum of Understanding (MoU) between the PRA and FCA.

5. *Are the powers of the FCA suitable? Will their exercise be subject to appropriate scrutiny? How should the FCA be interacting with industry as well as using its intervention powers?*

5.1 As previously stated, we are broadly supportive of the FCA's powers. Please refer to the answers to questions 3 and 4 for further detail on these issues.

6. *How will the break-up of the FSA work in practice?*

6.1 There should be appropriate focus on minimising the complexity and operational burdens that will be placed on dual-regulated firms. We note the Government's efforts to secure arrangements that will ensure the new authorities interact and co-ordinate effectively with each other, as well as with firms and with the European Supervisory Agencies. These mechanisms will be critical to avoid regulatory gaps. There must be delineation of powers and responsibilities as between the FCA and PRA, and it must be clear how decisions will be made when the FCA and PRA disagree on the treatment of a dual-regulated firm.

6.2 We would ask for a clearer commitment about how often the PRA and the FCA will review their performance, particularly in the context the effectiveness of the co-ordination mechanisms that the regulators will implement to comply with section 3D of the MoU. The regulators should each year disclose the results of this assessment in a joint publication. This report should be informed by feedback received from firms via a dedicated forum set up for the same purpose. The ultimate aim should be to report on the cumulative impact on dual-regulated firms of what we hope will not feel like two layers of duplicative supervision.

6.3 We welcome the new section 3E statutory MoU as a means of explaining how the regulators intend to comply with their duty to co-ordinate. We believe this to be an important document. As currently drafted, section 3E(1) seems only to require the inclusion of a general explanation. We would welcome more specific basic mandatory contents within the draft legislation.

6.4 Finally, we would seek clarification on the Government's intention when using the word "public" in new section 3E(8)(b). This provides an exception to publishing information in the MoU if the regulators believe that any aspect is a technical or operational matter not affecting the public. As with members of the public, regulated firms are affected by, and as such are necessarily interested in, such matters. We could therefore be disadvantaged if technical or operational information is not published on the basis that it is of no interest to members of the public. "Public" should be substituted with, for example, "market participants".

7. *How should the FCA be interacting with other domestic regulators?*

7.1 Clear lines of responsibility need to be drawn between the FCA and the OFT to ensure any overlap on, for example, pricing and competition policy is reduced.

7.2 We fully support the intention that there should be a strong focus on coordination for those firms regulated by both PRA and FCA.

7.3 We welcome the intention that the FCA will play an active and constructive role in shaping the development of regulation at a global and EU level alongside the Bank of England, HM Treasury and the PRA. This will be a vital role as the EU becomes more influential in shaping UK regulation—there are differences that need to be understood in areas such as interpretation, translation, applications and implementation.

7.4 Nationwide believes firms and consumers will benefit if the FCA is able to discuss openly with firms consumer information that it plans to collect and analyse. Complaints data supplied by the FOS is a key example. There is real potential to prevent widespread consumer detriment, minimise costs and reduce the disruption that is generated by mass claims; and ultimately foster a culture of efficient engagement with firms.

8. *How should the FCA be interacting with international regulators? Do EU regulation initiatives restrict or enhance the work of the FCA? Will the FCA be able effectively to engage with the EU supervisory authorities?*

8.1 We believe there is a case to be made for seeking to minimise the time, effort and resources that are devoted to engaging in a consultation process where the UK has limited or no discretion in the way that it must implement EU law.

8.2 Once it is clear that the EU is considering action in a particular area, it is important that FCA seeks input and responses from firms in order to inform FCA's (and thus UK firms) negotiating position. Coupled with any trade body involvement, this early input would only enhance the UK's position, potentially reducing regulatory burden and/or gold-plating and importantly would maximise regulatory efficiency.

October 2011

Written evidence submitted by the Investment Management Association

EXECUTIVE SUMMARY

1. The IMA represents the asset management industry operating in the UK, which at the end of 2010, was responsible for the management from the UK of about £3.9 trillion of assets invested globally on behalf of clients drawn from around the world.

2. IMA members will be a significant constituency for the FCA. We do not expect them to be prudentially supervised by the PRA and they will accordingly be amongst the largest and most global businesses solely subject to FCA supervision. The vast majority of all rules applicable to them, whether in conduct of business or prudential matters, derive from European Directives and Regulations such as MiFID, UCITS and the Capital Requirements Directive.

3. The objectives of the Financial Conduct Authority (FCA) do not go far enough in relation to competitiveness which is an important issue to which the regulators ought to have regard.

4. The FCA will need to have a deep understanding of, and good intelligence about, the markets it regulates.

5. Formal accountability to Government has limitations which we recommend is supplemented by other mechanisms such as: more visibility for non-executive directors; fuller disclosure of the FCA's reasoning with regard to rule changes; and a single independent complaints commissioner for all FCA and Prudential Regulatory Authority (PRA) complaints.

6. While action in relation to product intervention is important to avoid consumer detriment there must be legal certainty to ensure product innovation is not dis-incentivised in the UK. That said, the FCA should be more willing to make full use of all the powers available to it.

7. The FCA should commit to properly communicating what is and is not guidance.

8. In the exercise of the veto power by the PRA over the FCA, the Financial Policy Committee (FPC) should be consulted. Public interest publication of the veto decision and the reasons for it should be for HM Treasury and not the PRA to decide.

Are the objectives of the Financial Conduct Authority (FCA) clear and appropriate?

9. The objectives as drafted are clear but do not go far enough on competitiveness.

10. The current formulation in the Financial Services and Markets Act 1999 (FSMA) requires the FSA to have regard to "the international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom". Presently these words do not appear in the FCA's objectives. We disagree with the removal of a reference to competitiveness as a particular issue to which the regulators must have regard. We believe the removal of this obligation will be contrary to the UK's national interest. Supporters of the removal suggest that retention of the existing duty would result in a "race to the bottom" with damaging impacts on financial stability or consumer protection. But if the UK regulators fail to consider what the rest of Europe is doing, for example on a Single Market directive, more and more product launches will occur in Luxembourg or Dublin and passport back in to the UK.

11. Despite the Government's position on competitiveness, the Bill retains wording designed to protect the UK's position as a location of choice for firms wishing to list their shares. This was introduced by the Investment Exchanges and Clearing Houses Act 2006, in response to fears that a takeover of the London Stock Exchange could have resulted in the effective importation of the Sarbanes-Oxley Act and other US legislation. When considering whether any regulatory provision proposed by an exchange is excessive, the FCA will still need to have regard to all factors including "the global character of financial services and markets and the international mobility of activity, [and] the desirability of facilitating innovation." We think these are criteria which can be applied more generally: we do not see why the listing rules should be singled out for such protection, but not other powers and duties of the FCA.

Should the FCA have a primary duty to promote competition as recommended by the Treasury Select Committee and Independent Commission on Banking? How should this work in practice?

12. We have no strong views on the benefit of this over the Government proposals on referrals and super-complaints where there has been mass detriment. The nominated parties should command respect as independent and unconflicted bodies.

Does the FCA's approach to regulation, as outlined in the Financial Services Authority (FSA)'s June 2011 document, represent an improvement on that of the FSA?

13. We think it is too early to say. Certainly it will depend upon the strategies and approaches set by the senior management team of FCA. We have stressed the need for FCA to have a deeper understanding of the market and better intelligence. FCA will also need to address internal disagreements, as it is suggested there may have been over the timing and need to intervene concerning PPI mis-selling claims.

14. The FCA paper on supervisory approach does not address the use of external audit or review reports (under s.166 of the Financial Services and Markets Act (FSMA)) and we would be concerned were FCA to appear to have capped its costs by using more external investigators whose costs have to be met by firms direct.

To whom should the FCA be accountable? Are the lines of accountability clear?

15. Formally FCA must be accountable to Government, and through it to Parliament. We support the proposal to have four statutory Panels. We welcome the proposed role of the National Audit Office. There are limitations to such formal accountability; other mechanisms need to be in place to buttress it.

Non-executives

16. One possibility would be a more visible role for the non-executive directors. At present it is unclear to the industry what use is made of the skills and experience of the non-executives. By analogy with the role of non-executives on plc boards, they should be bringing an independent view to complement that of the executive team. And, just as non-executives in the corporate context can at times be a valuable conduit for external shareholders, so the non-executive directors of the FCA should be open to bring an external perspective to the FCA's deliberations. This is not to say that they should be seen as representative of industry, consumer or other stakeholder interests, nor that they should be seen as a legitimate target of lobbying by such interests. But they should be seen as providing a counterweight to executive management. As an example of what this might mean, individual non-executive directors could be charged from time to time with leading reviews of how policy has been undertaken or of specific regulatory episodes.

Publishing dissenting views

17. We would like to see a requirement for fuller disclosure of the FCA Board's reasoning for supporting or opposing specific rule changes. Dissenting comments should be recorded. Commonly we find the publication by the SEC of supporting and dissenting positions on regulatory issues very helpful. Similar practice by the Monetary Policy Committee has also been beneficial.

A single complaints commissioner

18. There should be a single independently-appointed complaints commissioner able to determine all FCA and PRA complaints (not one for each as proposed); this would prevent co-ordination complaints potentially falling between two commissioners. Whilst the current complaints commissioner role is relatively restricted (compared with the range of issues about which complaints as to FSA's actions might arise), the enhanced need for FCA and PRA (at least) to co-operate and co-ordinate may point to an increased role.

Are the powers of the FCA suitable? Will their exercise be subject to appropriate scrutiny? How should the FCA be interacting with industry as well as using its intervention powers?

Existing powers

19. FSA (*sic*) has a very wide range of powers. It is arguable that most of the steps the FCA might want to take on product intervention were already available to FSA under the own initiative variation of permission (OIVOP) power. The Financial Services Act 2010 widened them significantly. Overall there is a need to ensure the FCA does indeed use all the tools available to it. Despite all the existing powers of the FSA:

- There have been over one million cases at FOS since its establishment in 2000.
- Over £420 million has had to be raised by the FSCS for intermediary defaults in the last two financial years.

20. So we do not therefore oppose the policy behind the proposed new approaches to using existing (and additional) powers.

Product intervention

21. However the new Section 137C on product intervention is almost unlimited in its width. While we understand there is a need to consider product intervention on a much more proactive basis; the proposed clauses give unprecedented power to the FCA. The wording extends to almost any type of agreement. We think there is still a need for greater thought about how it might operate especially in relation to authorised persons providing cross border services and with contracts formed under the laws of other countries. Alongside a legitimate concern to ensure that consumers do not suffer detriment, there is a need to provide some level of legal certainty so as not to disincentive any form of product innovation in the UK.

The need for internal processes to ensure fairness

22. A more active ("intrusive") use of powers places an even greater burden on the FCA to ensure that its internal processes are of the highest standards. In this regard we remind the Committee of the strong criticisms made by the Financial Services and Markets Tribunal (as it was) in the Legal & General case and which led to the enforcement process review[14] by the FSA.

23. The speed at which the FCA may be expected to act in relation to some of these new powers demands that a much more explicit statement of internal processes and protections should be put in place (or preserved in the transition from the FSA). At present the Bill and the FCA approach document provide little material on which to assess the extent to which internal processes at the FCA will be fair and meet the expectations of administrative law. We note that the FSA was not required by FSMA to have this approach and moved to it only in the light of "well-founded criticisms" from the Legal & General case. For that reason, we would expect the legislation to expect proper separation of aspects of the investigation and decision-making processes within the FCA. It is entirely possible for legislation to provide sufficient detailed protections.

Greater clarity on rules, guidance and mere speeches

24. We would welcome far greater clarity from the FCA on the use of its rule-making powers compared to the FSA. It is only in the last year that FSA has effectively acknowledged that it has been publishing for years a series of documents (such as thematic reviews with recommendations) which most viewed as guidance, but which had not been subjected to the protections provided in FSMA of consultation and CBA. We would welcome a much clearer commitment from the FCA as to how it will identify guidance and other recommendations. Too many individuals at FSA felt able to make speeches at conferences which were meant to provide messages for behavioural changes but which led to greater uncertainty of application. If FCA wants firms to follow its guidance it should issue the same clearly and following any required process.

Improved dialogue with industry

25. For a more interventionist approach to succeed, market practitioners will have to have confidence they can speak about concerns with the FCA. At present dialogue between the industry and the Bank of England is of a different depth and quality than with the FSA. In part this arises from the FSA being the regulator but it is also about an approach which needs to be much less insular in policy formation.

[14] http://www.fsa.gov.uk/pubs/other/enf_process_review_report.pdf

Concerns over veto powers

26. We raise points about the power of PRA to veto the use of FCA powers below.

How will the break-up of the FSA work in practice? Issues of coordination and information sharing between the FCA and the Prudential Regulation Authority (PRA)

The veto powers

27. We have concerns over the veto power given to PRA over FCA (section 3H) and the risks that some banks will be over-protected; if not only through its use, but through FCA's perception of when it might be vetoed.

28. Generally we think the FPC as well as FCA should be consulted before its use; so section 3J(1) needs amending.

29. As regards publication, including to Parliament, of the veto decision and reasons for it, this should be for HM Treasury not (as proposed) PRA to decide what is in the public interest.

30. The veto power should never be able to be exercised in relation to any power given to FCA to prosecute a PRA-authorised person or bring a market abuse action.

Recognising the role of the FCA with client assets

31. Proposals about recovery and resolution plans and other crisis management issues have not yet recognised the role of the FCA as the body principally responsible for client asset protection policy. PRA will need to liaise with it in this regard.

Revising the permission regime and register

32. The regulated activities order and the FSA register and permission regime need to be fundamentally reviewed. There is no need for such a parochial and arcane system of permissions in light of European directives governing most activities of many firms. We remain to be convinced that the current system does anything other than add to costs and uncertainty. We cannot believe that consumers are assisted by having to consider several pages of permissions for a simple firm.

How should the FCA be interacting with other domestic regulators? For example, the FCA's relationship with the Bank of England and Financial Ombudsman Service

Market intelligence

33. The legitimate interest of the FCA to have better market intelligence must not lead to duplication by it (or the PRA) of work conducted at the Bank of England. We consider that the market intelligence unit of the Bank of England is likely to be the central place for a large part of the wholesale market intelligence that needs to be gathered, given the committees it serves, and we would expect the FCA to draw from it whilst maintaining its own expertise in consumer market issues.

34. There will also be a need for close co-operation with the Bank of England in relation to its existing markets work (such as the Stocklending and Repo Committee) and its market intelligence activity and with the Debt Management Office (DMO).

Learning from failures

35. FCA must be much more open to learn both from FOS but also from FSCS. A few years ago we asked if FSA ever formally reviewed any matters which might come to light form the handling of defaults by the FSCS. We were told not. Just as it was no surprise that an insolvency practitioner first suggested living wills for complex regulated firms, we would expect FSCS would have insights arising from its wide interaction with consumers and failed firms.

How should the FCA be interacting with international regulators? Do EU regulation initiatives restrict or enhance the work of the FCA? Will the FCA be able effectively to engage with the EU supervisory authorities?

36. EU regulation is a fact of life in the areas of business of IMA members. This means not only the source of rules but also (and increasingly) a restriction on any local variation or implementation. And over the next few years the European Supervisory Authorities will increasingly corral local regulators, such as the FCA, into harmonised approaches. This is a commitment the UK Government has made and the FCA will need to fit with it.

37. The FSA does effectively engage with the EU and internationally, it cannot always be successful but that is not a reflection on engagement, and we fully expect the FCA to continue to engage.

October 2011

Written evidence submitted by the Association of Independent Financial Advisers

Executive Summary

1. Failings in the regulatory framework became apparent through the recent financial crisis, and AIFA fully supports the reform of the regulatory framework that is required in order to correct these failings. As part of this reform agenda the opportunity should not be lost to improve the effectiveness of financial conduct regulation. This should be a process of evolution, and to this extent we are supportive of the approach being taken of making the changes by way of amending legislation rather than starting afresh. AIFA accepts that the separation of prudential and conduct regulation into a "twin peaks" approach can be made to work though there are important aspects, such as the European dimension, that will need to be carefully managed.

2. In the same way that the FCA will have a new role in promoting competition, AIFA believes that the FCA must also have regard to the wider public policy agenda in order to help consumers re-engage with their long-term financial well-being and make more, and better, provision for themselves. We think this can be achieved by requiring the FCA to publish, as part of any cost-benefit analysis, the impact the proposals would have on promoting competition, improving access to advice, and closing the savings gap. Specifically on economic competitiveness we agree that an extension of scope for the FCA is not appropriate: however it is stated that the FCA will make judgements regarding, for example, the value for money of products and may then intervene on price—further clarity is needed on what this might mean in practice.

3. FCA accountability must be more clearly demonstrated. AIFA fully supports the Treasury Committee taking an ongoing proactive role in holding the FCA to account. We also support the various Panels as providing important checks and balances, and the role of an independent assessor of value is essential. We believe that, beyond formal structures, the development of a responsive culture at the FCA can deliver significant additional benefits.

4. AIFA would like to see consumers embrace their responsibilities without in any way minimising the responsibilities that advisory firms, product providers and regulators owe to them. The change in the regulatory landscape provides a timely opportunity to define consumers' responsibilities more clearly in order to help consumers achieve optimum outcomes.

About AIFA

5. AIFA is the representative body for the IFA profession with membership on a voluntary and corporate basis. There are approximately 16,000 advisory firms that employ 128,000 people, and turnover is estimated at £6.5 billion (comprising £4.5 billion from life & pension policies; £1 billion from fund management; and £1 billion from mortgages and general insurance).

6. Around 20% of the UK population regularly use an IFA, with approximately 45% consulting one from time to time. IFAs currently account for around 70% of all financial services transactions in the UK (measured by value). As such, IFAs represent a leading force in the maintenance of a competitive and dynamic retail financial services market.

7. AIFA welcomes the opportunity to submit evidence to the Treasury Committee as part of its inquiry into the Financial Conduct Authority (FCA), and would be pleased to provide further evidence and insight as the Committee deems appropriate. Our submission focuses primarily on those aspects which impact upon our membership.

Introduction

8. AIFA recognises the important role that regulation plays in developing an efficient and effective retail financial services market in which consumers can have trust and confidence. We therefore fully support cost-effective and proportionate regulation which builds on that which already works. Given the significant importance of this market to individual consumers, the extent of regulatory intervention is understandable. Whilst we fully recognise the need for regulation to protect the interests of consumers, we feel equally strongly that it must improve the market's efficiency and effectiveness—and therefore its purpose must be made absolutely clear.

9. Constant regulatory change and uncertainty deters financial investment in firms and weakens consumer trust in the sector. In some cases regulatory initiatives actually threaten to undermine the existence of elements of the market as viable entities, restricting the ability of consumers to access important products and services from which they can derive significant benefit.

10. AIFA has identified six high-level principles that we believe should apply to the governance of regulation and which need to guide the approach to be taken by the FCA:

- regulation must enable better outcomes for more consumers;
- it is essential that regulation has the appropriate checks and balances in place to ensure accountability;
- regulation must work in a proportionate and risk-based way, focusing on those aspects of the financial services industry that pose the greatest risk;

- regulation must change less, with fewer "new ideas" and more consistency of delivery;
- it is essential that the regulator use its resources in the most cost-effective and economic way, in order to deliver the best possible value for money for both the industry and ultimately consumers; and
- regulation must take fully into account the European dynamic at play.

11. Failings in the regulatory framework became apparent through the recent financial crisis, and AIFA fully supports the reform that is required in order to correct these failings. As part of this reform agenda the opportunity should not be lost to improve the effectiveness of financial conduct regulation. In line with the principles outlined above this should however be a process of evolution. To this extent we are supportive of the approach being taken of making the changes by way of amending legislation rather than starting afresh.

12. AIFA accepts that the separation of prudential and conduct regulation into a "twin peaks" approach can be made to work. There are however important aspects that will need to be carefully managed:

- the implementation risks associated with the transformation to the new structure;
- the inconsistency with the sectorial approach being taken at a European level;
- the potential for duplication, additional cost, and under-lap—the development of robust Memorandums of Understanding will be particularly helpful; and
- any unintended consequences—for example potential detriment for consumers or advisory firms—of a system that focuses on financial stability at the macro-prudential level.

Objectives of FCA (Including Role in Promoting Competition)

13. AIFA believes that, in supporting the development of efficient and effective markets, regulation must not only protect consumers from unscrupulous market participants but must also focus on enabling better outcomes for consumers. The proposed strategic and operational objectives are not inappropriate in themselves. The promotion of competition has also been identified as one element worthy of consideration by the FCA as part of its duties. However, in defining its duties, we believe that further thought needs to be put into other aspects that will enable better outcomes for consumers.

14. As well as the duty to promote competition we believe the FCA must also look to facilitate:

- improved access to advice for consumers; and
- the closing of the savings and protection gaps.

15. There is evidence to suggest that, in recent years, regulatory practice has failed the consumer in a number of ways:

- the number of people saving long-term has fallen dramatically;
- the cost of advice has risen;
- consumer confidence and trust have been damaged; and
- efforts to promote public awareness through information overload have been largely ineffective.

16. Therefore, in the same way that the FCA will have new role in promoting competition, AIFA believes that the FCA must also have regard to the wider public policy agenda in order to help consumers re-engage with their long-term financial well-being and make more, and better, provision for themselves.

17. If the FCA has a remit that is overly-focused on protecting the interests of the individual consumer, without a balancing need to demonstrate the effect on the greater good, we risk a further dramatic erosion of the long-term savings culture in the interests of incremental improvement in outcomes for those that do save. The cost of regulation keeps rising and, by definition, consumers will not be able to obtain the products and services they need if the provision of those services is eliminated or made overly expensive by the actions of the regulator.

18. On the role that competition plays in practice, AIFA observes that its effect is different across the various parts of the retail financial services market. Consumers demand for long-term savings products, for example, is not necessarily driven by aspects such as transparency and disclosure—but rather by consumer behaviours that drive people towards instant gratification over deferred gratification. Indeed, even in the banking sector, low levels of current account switching are perhaps driven more by human behaviours than by aspects of competition.

19. In considering these other aspects which we believe that the FCA needs to have regard to—promoting competition, improving access to advice, closing the savings gap—there is a balance to be had. AIFA believes that a more public articulation of the impact of regulatory initiatives on these "have regard to" aspects would be beneficial. We think this can be achieved by requiring the FCA to publish, as part of their existing obligation to produce a cost-benefit analysis, the impact the proposals would have on these "have regard to" aspects. This would have the effect of allowing a range of stakeholders to comment on the impact of any given regulatory initiative as part of the consultation process.

20. From the perspective of economic competitiveness, AIFA supports the proposal which sees a role for the OFT rather then an extension of scope for the FCA. This will allow FCA to refer to specialist economic regulators where appropriate. Whilst there is acknowledgement that the FCA will not be an economic regulator, the need is identified to make assumptions on value for money (and indeed mention has been made of price intervention by the FCA). Value, by definition, is a subjective view of both the service or product offered and the cost. If the FCA attempts to operate in this space, we fear they will either undermine their work in the area of consumer responsibility (by second-guessing perceived value) or have to intervene on price (which appears to be akin to economic regulation). AIFA believes that further clarity should be provided of how the FCA intends to deploy its powers in this area.

Accountability and Approach

21. Whilst like the other new entities the FCA will be an "independent" regulator founded by statute, as a public body it must seek to tackle the perception held by some that it lacks accountability. Historically the system of accountability for the regulator has relied too heavily on internal self-assessment with the result that there were few external effective checks and balances in place. Accountability must be more clearly demonstrated, and the FCA should therefore be held more tightly accountable to the delivery of its objectives in the most efficient and cost-effective way.

22. The FCA will have direct accountability, of course, to HM Treasury. But, in addition to this, AIFA fully supports Parliamentary accountability in the form of the Treasury Committee taking an ongoing proactive role in holding the FCA to account.

23. AIFA believes that the various Panels have been a force for good in providing important checks and balances. We are therefore fully supportive of the maintenance of the Practitioner and Consumer Panels, and the new statutory footing of the Smaller Business Practitioner Panel.

24. AIFA believes that the role of an independent assessor of value is essential, and we think the National Audit Office have an important role to play in this respect.

25. AIFA recognises that, beyond the structures that will provide formal accountability, further improvement can be achieved as part of the cultural shift we expect to see in the FCA—as the FSA acknowledges, the success of the FCA will need to be achieved through cultural change. AIFA welcomes an approach that seeks to command the respect of both consumers and firms. We see that a culture of transparency and openness is vital to the achievement of the FCA's objectives, and in demonstrating the desired level of accountability. Success will lie in both the FCA and the industry recognising the value of collaborative engagement on the basis of open consultation and a clear dialogue. Such an approach will increase the likelihood of good policy decisions.

26. AIFA believes that the culture must be seen as being responsive as this is of vital importance for consumer trust and also industry respect. We would therefore like to see set out not only clear objectives and increased accountability but also a requirement to articulate the principles by which it will conduct itself in a manner that is responsive to the community it serves and that which it regulates. AIFA is supportive in principle of judgement-based regulation given the extent to which the benefit of experience can improve the decision making process. By definition it requires that the FCA has the necessary skills and expertise to exercise such judgement. This remains untested.

27. With regard to the prudential regulatory responsibilities of the FCA, AIFA continues to argue that the likelihood of failure is far less important than impact. Indeed, in our sector firms are often small and can exit (for example when the owner retires) but there are no systemic risks to consumers or to the smooth operation of markets. AIFA observes that historically IFA firms—that pose no systemic risk to the economy and are working in the best interests of their clients—have perceived that they have faced intrusive supervision from the FSA to a far greater extent than large banking institutions at the other end of the risk spectrum. The prudential requirements for firms in our sector are onerous and do not seem to tally with the revised approach to prudential regulation proposed by the FCA. This aspect is also relevant in the context of promoting competition as it places a significant barrier to entry for new firms.

28. The costs of coping with FSA regulation appear to keep rising. Furthermore, regulation under the FSA has been characterised by a considerable number of waves of different requirements with the result that a degree of regulatory fatigue has set in. The combined effect of these two factors is to drive members out of the market which acts to the detriment of consumers. It would be appropriate to conduct a review of best practice to identify areas where unnecessary costs might be eliminated.

29. Whilst we welcome the continuation of the use of cost-benefit analyses for new regulatory interventions and the increased use of post-implementation reviews, AIFA believes that more weight should be placed upon the overall cost burden on firms. The current structure and its accountabilities does not provide for an aggregate view of the cost of all regulatory entities on smaller enterprises, still less is there any assessment of the impact of incremental or additional costs on the overall availability of advice services to the consumer through a healthy and profitable advisory sector.

30. AIFA supports the continuation of the FCA's powers with regard to consumer redress schemes (and the resultant role of the Financial Ombudsman Scheme (FOS) as a handler of individual complaints) and also the

enhanced transparency between FCA and FOS with regard to identifying potential mass-detriment quickly. We continue to believe that there should be an extension of the long-stop to the actions of the FOS.

Responsibilities of Consumers

31. AIFA has historically supported the notion of consumer responsibility, and has previously agreed with the decision to drop the consumer champion aspect of the FCA which we believed detracted from the important consumer responsibility objective. It is important to be clear about the responsibility of all market participants in any financial transaction. Indeed we consider the wider issue of consumer responsibility to be an important factor within the regulatory architecture debate.

32. General consumer protection laws and the industry regulator offer protection from rogue and fraudulent entities, and consumers' rights are widely championed. With rights, however, come attendant responsibilities. AIFA would like to see consumers embrace their responsibilities without in any way minimising the responsibilities that advisory firms, product providers and regulators owe to them. We believe that, whilst in some cases additional responsibility may deter consumers, many will engage with greater attention to their requirements and will put a higher value on specific products or services. The change in the regulatory landscape provides a timely opportunity to define consumers' responsibilities more clearly in order to help consumers achieve optimum outcomes.

33. AIFA notes the FCA's desire to engage with consumers directly. We believe this is desirable but will want to be sure that this does not duplicate the work of the Money Advice Service (which is also industry-funded). The effective co-ordination of activities will be important.

European Dimension

34. With the ability of the European Supervisory Authorities (ESAs) to write binding technical standards that are directly applicable to UK firms, and the increasing focus on consumer protection now emanating from Europe, it is crucial that the UK is best placed to achieve positive engagement on the continent in the coming years and ensure we remain a leading player, for the benefit of consumers.

35. The European regime is based on a sectorial approach with each ESA having both prudential and conduct remits. In following a "twin peaks" approach therefore the interaction at a European level will need to be very carefully managed and co-ordinated to ensure positive interactions from a UK perspective.

October 2011

Written evidence submitted by the Association of Private Client Investment Managers and Stockbrokers[15]

1. *Executive Summary*

1.1 We accept that the FCA must be independent of government in conducting their regulatory activities but there is no effective mechanism for stakeholders to seek a review of policy decisions which are sometimes seen as plain wrong.

1.2 The FCA's approach to regulation should ensure firms are given adequate support to enable them to meet their regulatory obligations.

1.3 The role of Europe, both in terms of formulating policy and directing the manner in which competent authorities supervise firms, must be taken into account when determining the role of UK regulators and assessing their supervisory approach.

2. *Are the objectives of the Financial Conduct Authority (FCA) clear and appropriate?*

2.1 We believe the objectives of the FCA are clear and appropriate.

3. *Should the FCA have a primary duty to promote competition as recommended by the Treasury Select Committee and Independent Commission on Banking? How should this work in practice?*

3.1 The FCA should have a primary duty to promote competition. However, we are not entirely clear whether there is a common understanding amongst all stakeholders and the FCA as to the exact nature of this duty. The paper setting out the FCA's approach to regulation states "Options to strengthen competition are likely to include measures which reduce market power, including measures which affect firms such as reducing barriers

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[15] The Association of Private Client Investment Managers and Stockbrokers (APCIMS) is a trade association representing 170 member firms. Of this number 116 members are private client investment managers and stockbrokers and 54 are associate members who provide related services to our firms. Member firms deal primarily in stocks and shares as well as other financial instruments for individuals, trusts and charities and offer a range of services from execution only trading (no advice) through to full portfolio management.
Our member firms operate on more than 500 sites in the UK, Ireland, Isle of Man and Channel Islands, employing c.30 000 employees. Over £475 billion of the country's wealth is under the management of our members. Our aim is to ensure that regulatory, tax and other changes across Europe are appropriate and proportionate for the investment community.

to entry or exit, and measures which help consumers make better decisions by helping with search or switching." We do not disagree with this statement but we are of the view that the duty to promote competition directly impacts upon the operations of the FCA. Examples of the operational issues which may impact on the promotion of competition could include:-

— The time taken to authorise funds compared to the time taken by other competent authorities in Europe.

— The costs of regulation for UK firms compared to European competitors.

3.2 Any policy proposals should include an assessment as to whether or not the proposals really do promote competition. We have a recent situation of new rules from the FSA whereby an additional burden has been placed on firms to communicate with underlying holders of unit holders in nominees. The rules specifically state that firms cannot levy a charge for this new activity. This we feel will affect firms' profitability and therefore introducing a competitive disadvantage since this is not a European requirement.

4. *Does the FCA's approach to regulation, as outlined in the Financial Services Authority's June 2011 document, represent an improvement on that of the FSA?*

4.1 We are unable to assess, at this stage, whether or not the FCA's approach represents an improvement to that of the FSA. There are a number of areas which FCA needs to address which we set out below.

4.2 Assisting authorised firms meet their regulatory obligations—APCIMS member firms, in common with most authorised businesses, want to ensure they meet their regulatory obligations. The FCA's proposed regulatory approach does not recognise that it could significantly improve the FSA's approach to regulation by ensuring that firms are given assistance to meet their regulatory obligations rather than just being penalised when it is deemed that they have done something wrong.

4.3 There are a number of operational issues which the FCA should address to improve the assistance provided to authorised firms, a non exhaustive illustrative list of issues to be addressed is set out below:-

— Better management of the nature, extent, and timing of regulatory communications—the current volume of material is simply too great for firms to review and absorb;

— Clearer identification as to what communication is relevant for what types of firms;

— Review of support material produced for each sector together with a control to ensure such material is subject to periodic updating and, if applicable, removed;

— Review of the communication strategy and particularly the website which is seen by the industry as no longer fit for purpose;

— Greater transparency regarding the process adopted for undertaking specific theme visits identifying the FCA's expectations and approach at sector level;

— Earlier feedback of issues emerging from theme visits; and

— An independent review of the current operational effectiveness of the firms contact centre, with recommendations on how the service to firms could be improved. Any review should include extensive consultation with firms.

4.4 Intelligence—The FCA's regulatory approach is largely based upon "the work of the new business and market analysis team and analysis of business models"; we are concerned that the team will be "desk bound academics" rather than experienced individuals, who are actively and continuously engaging with the industry in a credible manner to ensure they are aware of market developments. If the FCA is to meet its aspiration to command the respect of the firms it regulates then it must ensure its actions and those of its staff are taken on the basis of a thorough understanding of our member firms' business models. The FCA needs to carefully segment the market so that there is sufficient expertise within each segment and recognise, for example, that the service offering of a private client investment manager is different from that of an independent financial adviser. The team responsible for each sector must actively and continuously engage with trade associations and individual firms to maintain their specialist knowledge and identify market developments. Whilst team members are regulators they should also be seen by the industry in part as their sector's ambassador within the FCA, charged with ensuring policy development and supervisory actions reflect an understanding of each sector's business models.

5. *To whom should the FCA be accountable? Are the lines of accountability clear?*

5.1 The FCA will be required to publish an Annual Report which will be laid before Parliament and hold an Annual General Meeting. The nature and extent of the FCA's powers and activities have a major impact upon regulated firms and consumers. We believe there should be a mechanism for greater involvement of HM Treasury in having powers, in exceptional circumstances, to review policy decisions. Policy proposals and resultant rules originating from the FSA can potentially significantly impact upon our member firms' business models. We recognise that increasingly many of the resultant rules will originate from Europe, however, in respect of UK rules we do believe the level of accountability could be improved. Whilst we assume that all rule changes will be subject to formal approval by FCA's Board, our experience of the FSA is that the scope, scale and complexity of certain rule changes are such that the degree of independent review and challenge that can be exercised by the FSA's Board is limited. There have been occasions where our sector has concluded that the resultant rules of the FSA are wrong, not because we do not support the policy intent, but because the resultant rules have failed to be drafted in a way that takes account of our member firms' business models.

5.2 Where a reasonable number of firms disagree with a particular proposal the FSA still proceeds with its own view for the resultant rules, often because it says (and believes) it is right? We need therefore some sort of "third referee" to listen to evidence from both the marketplace and firms in such cases so that one more round of pragmatic review occurs. Such a process, if performed efficiently, would add great value to the overall fairness and balance of the final rules.

5.3 The financial services regulators are directly funded by the regulated firms in contrast to many other industries where their regulator is funded from taxation. Whilst the level of fees is subject to a consultation process this is inadequate. No historic costs data is provided and there is no supporting cost trend analysis. In the past, fees have increased to fund investment in IT designed to reduce the costs of the FSA but there has been no subsequent feedback as to whether the projects were delivered on time and on budget or whether or not the anticipated cost savings have been achieved. We note the cost of regulation has increased significantly throughout the tenure of the FSA and we are concerned about the potential cost of the FCA.

5.4 The FCA "will be clear about what firms can expect from" the organisation but it is, in fact, unclear from the paper what firms can actually expect from the FCA for example:

— What are the criteria against which regulated firms should judge whether or not the FCA is properly meeting its supervisory obligations?

— What external assurance can be provided that FCA's supervisory approach is, and continues to be, fit for purpose and the associated procedures are being followed by FCA staff?

— What reviews will be undertaken by the FCA, or another appropriate body, in respect of firms who have defaulted to determine whether or not the default is not a failure of the FCA to fulfil their supervisory obligations and to identify whether or not there could be refinements to the FCA's supervisory approach to mitigate the risk of default in future?

The FCA should be as transparent as possible about the detail of their supervisory processes including the internal standards FCA staff should meet in their interaction with firms.

6. *Are the powers of the FCA suitable? Will their exercise be subject to appropriate scrutiny? How should the FCA be interacting with industry as well as using its intervention powers?*

6.1 The powers of the FCA are suitable but we are concerned that they are subject to appropriate scrutiny. Product intervention and the publication of warning notices are very powerful tools and could result in firms ceasing to be in business. It is important therefore that sufficient safeguards are built into the decision making process to minimise the risk of erroneous decisions being made. Our understanding is that the publication of a warning notice would be subject to the approval but it is unclear what arrangements for independent scrutiny will be put in place for product intervention.

7. *How will the break-up of the FSA work in practice? Issues of coordination and information sharing between the FCA and the Prudential Regulation Authority (PRA)*

7.1 The majority (90%) of APCIMS member firms will be regulated just by the FCA. The current internal arrangements the FSA is putting in place to reflect the regulatory reforms should assist a smooth transition to the new regulators. The key concern for our members is whether the PRA, who will represent the UK at the European Banking Authority, will adequately consult with the FCA to ensure that sufficient recognition is given to the fact that European prudential regulation also impacts on small investment firms where the nature and scale of their activities and associated risks are totally different from banks.

8. *How should the FCA be interacting with other domestic regulators? For example, the FCA's relationship with the Bank of England and Financial Ombudsman Service ("FOS")*

8.1 Our expectation is that the FCA will actively engage with all domestic regulators and other bodies such as the Financial Services Compensation Scheme ("FSCS"). We would expect the FCA to ensure that decisions made by the Bank of England and the PRA do not inadvertently impact on FCA regulated firms. In addition we would expect the FCA to proactively review trends emerging from FOS. In terms of the interface with FSCS we are of the view that FCA should undertake a regular review of the reasons for defaults arising to determine whether or not there are issues for the industry to be aware of issues that need to be considered in their supervision of firms.

9. *How should the FCA be interacting with international regulators? Do EU regulation initiatives restrict or enhance the work of the FCA? Will the FCA be able effectively to engage with the EU supervisory authorities?*

9.1 We would expect the FCA to interact fully with all relevant international regulators. The work of key organisations such as the G20, G8, Financial Stability Board (FSB), BIS, IOSCO, IAIS, IASB, and other global bodies increasingly has effect on national jurisdictions through an articulated implementation process which in Europe gains enforceable legal form at EU level. The FCA must be involved sufficiently far upstream to influence ideas and processes at their inception, when there is enough fluidity to allow for inputs from different sources, if it is to minimise the risk of being caught later by potentially disadvantageously legislative proposals when room for manoeuvre is less. In some cases the FCA will want to get seats on the relevant organisation and should bid for them. In others it will need to work through HM Treasury or other relevant Government Departments who will represent the UK. Bilateral relationships with key foreign regulators such as the SEC and CFTC in the USA, the Japanese FSA, and others around the world including the major EU counterparts, will continue to be essential to the functioning of regulation in London's global marketplace. The FCA must be encouraged to form such relationships as necessary. At all times it should coordinate closely with the PRA and Financial Stability Committee so there is agreement on how UK international regulatory business is to be shared and on arrangements for information sharing so that all key UK organisations are fully briefed.

9.2 To achieve these objectives it is imperative that legislation underpinning FCA empowers it to hold an international remit. It must not be weakened by the narrow argument that since its jurisdictional reach is limited to the UK its influence should be so limited also. In this regard we are concerned that at the European level the Bill pays insufficient attention to the position and impact of EU legislation on UK regulatory business. The development of a new European structure of financial regulation in which the European Securities Authorities (ESAs: the European Banking Authority (EBA) in London, the European Securities and Markets Authority (ESMA) in Paris, and the European Occupational Pensions and Insurance Authority (EOPIA) in Frankfurt) are separate from the member states, report to the European Commission, have binding powers over national regulators and supervisors to compel them to implement European law and rules, and will in time write the Single European Rule Book, or Technical Standards, will limit the regulatory policy and supervisory discretion of the FCA (and other UK regulators) even more than is already the case. In addition, the stream of financial sector legislative and regulatory initiatives from the European Commission and European Parliament in Brussels that already determines a very high proportion (about 80% on some estimates) of the regulation that the FSA must currently put into effect, shows no sign of diminishing and may very well increase under the new more centralised arrangements.

9.3 The FCA must be empowered to deal adroitly with the ESAs and to develop a relationship with them that enables it to exert maximum influence, especially over regulatory policy formulation and rule making, within the new legal framework. A subservient relationship in which it simply takes instructions but has no meaningful interaction must be avoided. It will need to form alliances with other EU regulators in this process and the law should envisage this. Only by adopting a proactive approach based on interaction with other important stakeholders can the FCA work to ensure that EU regulatory initiatives enhance rather than restrict its business. Otherwise the process is more random with a general tendency since the FSA's foundation to press additional regulation onto the UK without the benefit of extra investor protection, thus adding unnecessarily to costs while limiting the FSA's ability for manoeuvre. On the other hand the FSA is guilty of gold-plating directives to a greater extent than any other regulator so in terms of the overall regulatory burden the UK has suffered from self-inflicted costs whose benefit it is difficult to discern, while the FSA has channelled itself into areas from which it has been difficult to back out even when there has been a clear need to change policies.

9.4 So not all difficulties have emanated from the EU. In order to ensure that the FCA does not make the same mistakes the law should not only require it to seek maximum effective early engagement with the international, European and other national authorities with a view to influencing policy formulation in a manner appropriate for the UK markets, but to do so in a way that will minimise any need for the gold plating of any measures that have been internationally or regionally agreed. If it wishes to do this the FCA should be required to demonstrate clearly and in public the rationale for such action, and to be subjected to cross-examination on the rationale before proceeding. This should ensure that only in essential cases where there was a public consensus in favour of additional regulation for the UK would gold plating be undertaken. And that in itself would only be possible under minimum harmonisation EU measures and in the event that under the new ESA régime, which aims *inter alia* to ensure consistent implementation of directives and regulations across the EU, the system of national discretion which allows for gold plating would still apply.

October 2011

Written evidence submitted by the Association of British Insurers

Introduction

1. The ABI is the voice of insurance, representing the general insurance, investment and long-term savings industry. It was formed in 1985 to represent the whole of the industry and today has over 300 members, accounting for some 90% of premiums in the UK. The ABI's role is to:

- Be the voice of the UK insurance industry, leading debate and speaking up for insurers.
- Represent the UK insurance industry to government, regulators and policy makers in the UK, EU and internationally, driving effective public policy and regulation.
- Advocate high standards of customer service within the industry and provide useful information to the public about insurance.

— Promote the benefits of insurance to the government, regulators, policy makers and the public.

Executive Summary

2. The ABI welcomes the opportunity to provide input to the Treasury Committee's inquiry into the Financial Conduct Authority (FCA). We have responded below to the questions set out in the Committee's terms of reference, but we first wish to highlight the main issues which we believe need to be addressed by regulatory reform.

3. The UK needs a regulatory framework that commands consumer and industry confidence and allows a competitive market to deliver positive outcomes for consumers. The FCA should not restrict itself to avoiding negative outcomes (eg mass mis-selling problems)—it should also put value on, and strive for, positive outcomes (eg well-functioning markets deliver products to consumers that meet their basic financial needs).

4. The FCA needs to be wary of developing a culture which is inherently hostile to the industry and fosters an adversarial atmosphere. Individual firms that treat customers unfairly can rightly expect to face regulatory action. However, we need to build a common purpose between the regulator, the industry and consumers if we are to achieve positive outcomes.

5. While we would welcome a more proactive approach to addressing real risks of consumer detriment and market failure, we do not see the case for additional rules and powers, such as product regulation. Instead, the FCA should focus on effective supervision of the existing FSA principles and rules, particularly of the core treating customers fairly requirements. Where a more interventionist approach is called for, this should be exercised with caution and with the proper safeguards in place.

6. Financial services markets are diverse and wide-ranging, and the potential for market failure and/or consumer detriment will differ substantially. For example, there are many insurance product markets, and the degree of consumer protection regulation in the market for personal pensions is more intensive than for the home contents insurance market.

7. Meanwhile, consumers in wholesale markets are generally much more confident and able to ensure that they get good outcomes from the market without requiring significant and potentially costly regulatory intervention. Care is therefore needed to prevent unintended consequences from rule changes designed to address retail issues which "leak" into the commercial and non-retail sphere.

8. Finally, we urge the Treasury Committee to scrutinise not only the accountability of the FCA, but also the accountability of associated bodies such as the Financial Ombudsman Service, and their fit within the new regulatory framework.

October 2011

Annex

Questions for Consultation

Q1. *Are the objectives of the FCA clear and appropriate?*

9. The ABI considers that the proposed strategic and operational objectives are a sensible balance. However, the FCA should be explicitly required to facilitate consumer "access" to financial services. The FSA often points out that it is not statutorily required to put weight on the potential benefits from more consumers having access to financial products that meet their basic financial needs. If the Government wants to ensure that the FCA does not act as a barrier to additional saving and a resilient society, we suggest a reference to access should be added to the efficiency/choice objective.

10. We also propose that the regulatory principles should include a requirement on the FCA to take account of the competitiveness of the UK financial services industry in setting its rules. The FSA is subject to a similar requirement. The UK financial services industry is a world leader and this provides substantial benefits to the wider UK economy through creating many skilled jobs, its impact on the balance of payments and on tax receipts. An effective regulatory environment is a competitive advantage for UK firms but it is essential that regulation does not damage the UK's attraction as a centre for financial services or add burdensome costs for UK wholesale and retail consumers.

Q2. *Should the FCA have a primary duty to promote competition as recommended by the Treasury Select Committee and Independent Commission on Banking? How should this work in practice?*

11. The ABI welcomes a greater regulatory focus on effective competition given its importance in delivering good outcomes for consumers. However, we agree with the Government that the pursuit of competition should not be the exclusive objective of the FCA, given the other important considerations such as consumer protection and market integrity.

12. We urge further consideration of the practical implications of the FCA's role in ensuring competition in financial services. The Independent Commission on Banking has recommended that the FCA should take a lead in encouraging consumers to switch between providers and in promoting price competition. Given the

Office of Fair Trading (OFT) will retain general competition law powers and the right to conduct market studies in relation to financial services markets, there is a risk of duplication and lack of coordination between the two bodies. We suggest the FCA and the OFT ought to be subject to a statutory duty to cooperate and to produce a Memorandum of Understanding (the FSA and OFT have voluntarily published a MoU in recent years). This should make clear that the FCA will normally take the lead on competition matters in financial services markets, so the OFT will only undertake market studies in exceptional circumstances. The activities of the FCA and the Money Advice Service in enhancing information and the financial education of consumers will be critical in making competition work in practice.

Q3. *Does the FCA's approach to regulation, as outlined in the Financial Services Authority (FSA)'s June 2011 document, represent an improvement on that of the FSA?*

13. The FCA's approach to regulation is at an early stage of development, so it is too early to assess if it will represent an improvement on that of the FSA. However, we do welcome the increased emphasis upon the benefits that effective competition can deliver to consumers, and the commitment to improving the quality of business and market analysis.

14. We also support a more proactive approach to regulation but this should be risk-based, focusing on retail markets where there is evidence of consumer detriment and market failure. The FCA needs to be wary of developing a culture which is inherently hostile to the financial services sector and fosters an adversarial atmosphere. We need to build a common purpose between the regulator, the industry and consumers if we are to achieve positive outcomes.

15. We can see little need to add to the FSA's extensive rulebook and instead suggest the FCA should focus on effective, proactive and consistent supervision of the existing requirements on firms to treat customers fairly, including when developing products.

16. Finally we are concerned that the approach of the FCA, with its strong consumer focus, creates a risk that wholesale market conduct will be viewed through a retail lens, leading to inappropriately burdensome levels of regulation for these markets. The regulator will need to tread carefully in obtaining real insight into relevant risks and the drivers of innovation and will also need, within the framework provided by the Financial Policy Committee (FPC), to interface with Bank of England and the PRA to ensure a sensible and proportionate regulatory response.

Q4. *To whom should the FCA be accountable? Are the lines of accountability clear?*

17. The ABI is generally content with the proposed arrangements for the accountability of the FCA. We particularly welcome the provision in the draft Bill for the National Audit Office (NAO) to launch value for money investigations into the FCA (and also the Financial Ombudsman Service). We also urge the Treasury Committee to continue to play a key role in scrutinising the quality of financial services regulation by regularly launching inquiries into the performance of the FCA.

18. We do, however, have serious concerns about the erosion of "due process", in various parts of the Bill. In a more interventionist and judgement-based regulatory environment, the ability to challenge the regulator's decisions should be strengthened not weakened. For example, we are surprised by the proposal that the Upper Tribunal should no longer be able to express an opinion about the appropriate cause of regulatory action in the event that it does not uphold the FCA's original regulatory decision.

Q5. *Are the powers of the FCA suitable? Will their exercise be subject to appropriate scrutiny? How should the FCA be interacting with industry as well as using its intervention powers?*

19. The ABI is concerned about the additional product intervention powers proposed in the draft Bill and, in particular, the scope for FCA to make temporary product intervention rules without consultation and cost-benefit analysis. Although FCA will be required to publish a statement of policy we are not persuaded that the suspension of basic regulatory disciplines is justified. Legislative safeguards are needed to ensure that any such power is used as a last resort rather than on a regular basis.

20. We are also opposed to the early publication of disciplinary action against firms and we are disappointed that the Government is proposing a regulatory power which appears contrary to natural justice. There is a risk it will cause lasting reputational damage to firms before the facts have been fully determined, and before the case has been proven. At the very least, we propose there should be stronger statutory safeguards on the use of the power, such as requirements on FCA to consider the impact of the disclosure upon the firm, and to publicise discontinuation of the enforcement action.

21. Fundamental to the effectiveness of outcomes focussed regulation will be the quality of supervision and the competence of staff. It is vital that the FCA develops a robust supervisory process underpinned by high quality staff.

22. The ABI has reservations about the FSA's increased use in recent years of "skilled person reports" as part of the supervisory process. The scope, cost and number of these reviews has increased considerably and if this trend continues under the FCA this may exacerbate the risk of a loss of in-house understanding of

individual firms. Given the direct cost of such reports to firms, over-use of this tool also contradicts the second regulatory principle to ensure that any burden imposed on a person should be proportionate to the benefits. We also consider the proposed extension of scope of these powers to impact non-regulated companies—purely by virtue of being a listed company—to be disproportionate.

Q6. *How will the break-up of the FSA work in practice? Issues of coordination and information sharing between the FCA and the Prudential Regulation Authority (PRA)*

23. Close co-ordination between the PRA and FCA will be necessary to ensure that the new regulatory structure operates in an efficient and effective manner. It is particularly important for dual-regulated firms that there is effective co-ordination in order to ensure a consistent and proportionate approach to regulation. We, therefore, welcome the proposed statutory duty of co-operation, and suggest it should be extended to include a specific requirement on both bodies to work together to minimise the total costs of regulation.

24. The Government should ensure that a draft of the MoU is available for public discussion during this pre-legislative scrutiny phase, rather than being delayed until the Bill is introduced.

25. Currently there is no requirement for the PRA and FCA to consult on changes to the MoU—we believe that the authorities should be required to consult. How the authorities work together will impact directly on regulated firms and it is important that they are able to comment on proposed changes which may impact on them. We are also concerned that the MoU allows technical or operational issues relating to co-operation to be omitted. These issues have a direct and material impact on firms.

26. However, whether the arrangements work in practice will be dependent on the working relationships between the parties rather than on the legal requirements. The FSA and Bank of England should ensure close working relationships between the units that will become the PRA and FCA are built up and maintained during the period of "internal twin peaks". These close working relationships will need to be formed at all levels of the respective organisations.

27. There is a clear risk that fees will increase under dual-regulation. We need transparency and accountability to ensure that costs and fees across both regulatory bodies (together with FOS, FSCS and MAS) are proportionate and represent value for money for customers who, ultimately, finance regulatory costs.

28. Finally, the proposed timetable is very ambitious. Insurers are facing other substantial regulatory developments, for example the Retail Distribution Review and Solvency II. Both firms and the regulatory authorities are stretched responding to these developments and have limited capacity to absorb further changes. The current timetable does not appear to make provision for any transitional arrangements—firms will require time to make changes to documentation and review and implement changes arising from the new rulebooks.

Q7. *How should the FCA be interacting with other domestic regulators? For example, the FCA's relationship with the Bank of England and Financial Ombudsman Service*

29. The FCA will need to form and maintain close relationships with the Bank of England. The FPC's work on macro-prudential measures will impact substantially on the FCA and it must ensure that it is fully involved in the FPC's work (it will not be adequate simply to rely on the FCA's CEO being a member of the FPC). We have a particular concern that responsibility for regulation of clearing and settlement will rest wholly with the Bank of England—this is vital architecture that supports the operation of markets so it requires a close working relationship to be established with the FCA as the regulator of markets. We believe an appropriate specification of shared responsibility, which has precedents in other jurisdictions applying similar twin peaks regulatory model, is needed for the UK.

30. The FCA should review the relationship with the Financial Ombudsman Service (FOS) and take lead responsibility for resolving broader regulatory issues arising from complaints. We agree with the Government that the FOS should be able to focus on processing individual complaints on a case-by-case basis rather than having to deal with mass issues. We hope that there will be few, if any, cases of mass detriment in the future, given the FCA's commitment to early intervention and the work of the insurance industry and others to address risks of consumer detriment. But if there are future cases on the scale of PPI we agree it would be better for the regulator to take the lead in resolving the matter rather than FOS.

31. More broadly, we suggest that it is not the role of individual ombudsmen to privately make final decisions on precedent-setting cases, which could have wider implications for potentially thousands of similar cases. The small minority of cases that fit into this category ought to be referred to the FCA or the courts.

32. So we propose the legislation and FCA rules should set out a clear process for decision-making on cases requiring regulatory or legal clarification. The legislation should also require FOS to take account of the relevant regulation at the relevant time when making determinations.

33. To strengthen the accountability of FOS, we suggest FCA should conduct regular reviews of its overall efficiency, effectiveness, policies and procedures. This would not, and should not, compromise the operational independence of ombudsmen when adjudicating on individual cases.

Q8. *How should the FCA be interacting with international regulators? Do EU regulation initiatives restrict or enhance the work of the FCA? Will the FCA be able effectively to engage with the EU supervisory authorities?*

34. The proposed UK architecture does not fit well with the EU structures. The European Supervisory Authorities (ESAs) are based on a sectoral approach (banking, insurance, securities) rather than the functional (prudential and conduct) approach being pursued by the UK Government. This will mean that there will be an onus on the UK authorities to ensure proper co-ordination to ensure that UK interests are fully represented on the ESAs by the appropriate authority.

35. The European Commission and the ESAs are becoming the main source of detailed regulatory requirements for UK financial services firms for both prudential and conduct issues. In order to retain their influence the UK authorities will have to do more to influence the process of setting EU rules. This is likely to require new skills on the part of UK representatives on the ESAs—negotiating and influencing skills and a higher level of political awareness will be needed in addition to a high degree of technical skill. The UK authorities should also work closely with industry to ensure wherever possible that a unified UK approach is taken.

36. We are concerned that some of the powers proposed for the new bodies may go beyond what is permissible under EU law. For example, it is by no means clear that all of the new product regulation powers proposed for the FCA are permissible for all product lines. Clearly it is essential for the Government to provide certainty about the compatibility of the proposed powers with EU legislation and the implications for different parts of the financial services sector.

37. The FSA's FCA Approach to Regulation document says very little about the EU context in which the FCA will operate. The document hints at some resistance to further harmonisation of conduct regulation. We need a proper open debate about the pros and cons of this—which we see to a large extent as inevitable, as a result of the far-reaching initiatives at EU level in the retail area expected in 2012.

Written evidence submitted by ICAEW

Introduction

1. We are writing to provide evidence in response to the call for evidence by the Treasury Committee on the Financial Conduct Authority (FCA). ICAEW would be pleased to provide oral evidence on any aspect of its submission.

Who We Are

2. ICAEW is a world leading professional accountancy body supporting over 136,000 members in more than 160 countries. With a Royal Charter, we work in the public interest with governments, regulators and industry to maintain the highest business and ethical standards. We are also a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

3. ICAEW established a Financial Services Faculty in 2007. It draws together professionals from across the financial services industry and from the 25,000 ICAEW members in the sector, including those working for regulated firms, in professional services firms, intermediaries and regulators.

Executive Summary

4. As discussed in more detail later in the submission, our key points are:

- We agree with the emphasis in the FCA launch document on changes to the regulation of retail—rather than wholesale—financial markets. The fundamental differences between wholesale and retail markets must continue to be recognised by the FCA.
- The proposed objectives of the FCA are broadly appropriate, but we advocate adding an operational objective of reducing financial crime, or at least specifying clear mechanisms through which the FCA can contribute to this.
- The FCA should have a statutory objective in relation to competition, particularly to improve retail and SME banking services. This can be achieved by working closely with the main competition authorities.
- The proposed FCA approach is certainly stronger than that of the FSA. However, the FCA needs to adopt a materially more robust approach to retail markets, based on a clear idea of what well-functioning markets look like and a readiness to intervene where there are shortcomings.
- It should seek to build a clear, public consensus on the features of well-functioning financial markets.
- The FCA should identify the specific needs of different customer segments, such as financially excluded, mass market and high net worth individuals, and focus particularly on the mass market for greatest impact.

— The FCA should be accountable to Parliament. It should design a limited number of straightforward measures of success, for example survey results on trust, and numbers of consumer complaints.

— The powers of the FCA are broadly suitable—but it will need to interact with the industry and consumers in a structured and intense way in order to deploy these to best effect. Past problems have often reflected shortcomings in operational supervision rather than powers available.

Context

5. From both a social as well as individual consumer point of view, there is a strong case to establish a new conduct regulator which has a clear mandate to foster a well-functioning retail market, particularly to improve financial capability and trust.

Raising the level of financial capability across the UK

6. Demographic developments, together with the fiscal implications of the possibility of growth remaining low in the West for some years to come, suggest that Governments are likely increasingly to look to individuals to make greater personal provision for retirement and possibly other requirements, such as aspects of health care. That implies a need to raise the financial capability of the general population. Financial education will be an important part of this.

Improving trust in the financial services sector

7. Trust in the sector needs to be improved given the history of mis-selling and poor service standards. The volume of complaints received by UK financial services firms amounted to over 1.8 million in 2011 H1, half of which were upheld. These outcomes are profoundly disappointing after around 25 years of formal regulation. They are bad for consumers, but also the many firms in financial services which are run on sound lines yet become grouped with those which are not.

Responses to Selected Questions

Q1: *Are the objectives of the Financial Conduct Authority clear and appropriate?*

8. Overall, yes. However, ICAEW believes that the FCA should be given an operational objective of reducing financial crime (including market abuse)—as the FSA currently has—or at least clear mechanisms through which the FCA can build on the notable recent successes of the FSA in this area. It is essential that those responsible for the regulation of financial conduct have a way of ensuring that possible financial crime they identify is investigated and, where appropriate, prosecuted.

9. Economic crime can have very corrosive effects on economic efficiency. We are concerned about the apparent lack of attention being given to this issue in consideration of financial regulatory reform.

10. *Recommendation:* the Committee should investigate how the Government proposes to address financial crime issues within the proposed new arrangements, having regard to the future of all the main public agencies which deal with economic crime.

Q2: *Should the FCA have a primary duty to promote competition as recommended by the Treasury Select Committee and Independent Commission on Banking? How should this work in practice?*

11. Yes. Strong competition is especially important in retail financial markets, as customers are generally not in a position to negotiate individual terms with providers.

12. There are well documented market failures in retail financial markets, which means that competition may not necessarily be as straightforwardly beneficial for consumers as in many other markets for retail services or goods. Nonetheless, there are financial markets where stronger competitive forces probably would deliver better outcomes for consumers—including two markets highlighted by the ICB, namely those for personal current accounts and SME banking.

13. In order for the FCA to perform its "conduct of business" role it will need to have a detailed knowledge of how markets, and the more significant firms within them, work in practice. So the FCA should be well placed to identify factors which may be impediments to competition.

14. *Recommendation:* We believe that the FCA should be given a statutory objective to work with the competition authorities on the identification and—where appropriate—removal or mitigation of such barriers. To fulfill this role, the FCA would need to establish an internal unit of staff with expertise specifically in competition analysis, policy and law, especially to provide guidance to FCA staff on what to focus on in this area.

15. The FCA should take account of the impact of its regulatory work on willingness and capacity to supply financial services—for example, it should take care not to create unnecessary barriers to entry.

Q3: *Does the FCA's approach to regulation, as outlined in the Financial Services Authority (FSA)'s June 2011 document, represent an improvement on that of the FSA?*

16. As noted above, we agree with the FSA that the main area where change is needed is in respect of retail financial markets.

17. The UK needs to move from a position in which there is insufficient trust in retail financial services to one in which there is a high level of confidence (one facet of this would be no repetition of major episodes of mis-selling). We are not fully persuaded that the difference in approach between the FCA, as currently described in the launch document, and the existing FSA is commensurate with the scale of change required in outcomes for retail consumers.

18. We agree that the changes envisaged compared to the FSA are likely to be helpful—for example, the emphasis on a new business and market analysis team; and powers to complement the FSA's intensive work on retail distribution, notably in the areas of product intervention and financial promotions. It will be important that the business and market analysis team has a sufficient number of senior staff who come from a range of relevant backgrounds e.g. the industry, economic analysis etc.

19. However, to make a sufficient difference, in our view the FCA will need to have the confidence to articulate, and build public consensus around, what well-functioning markets would look like, and to take action to remove the fundamental causes of shortcomings from that standard.

20. The most significant source of market failure is the information asymmetry between providers and consumers. There are many examples today in which major financial institutions are failing to take adequate steps to redress the balance in information—for example, failing prominently to point out the limits of FSCS protection in advertisements for deposits, and marketing of structured products the risks of which are far from fully transparent even to market professionals.

21. *Recommendation:* In our view, the FCA will need to adopt a focused and determined approach along the following lines:

- Articulate a "typology" of consumers (for example, financially-excluded, "mass-market" and high net worth).
- Identify the main financial services requirements these groups are likely to have (for example, bank account facilities; loans, including mortgages; savings for particular purposes eg retirement; and protection policies, such as general insurance, critical illness and life cover, medical insurance etc).
- Drawing on the full range of information available to the FCA, identify market failures in the markets identified above (a "market" being for a particular product type bought by a specific customer group).
- Being prepared to take robust action to address significant market failures. This will require a cadre of expert supervisors with detailed expertise in different products and distribution channels—especially as it will be vital to recognise differences among firms and markets and not regulate to the lowest common denominator, which would raise costs unnecessarily. The focus should be on outcomes for consumers rather than firms' processes per se.

22. We believe that publication by the FCA of plenty of examples of good and bad practice by regulated firms would have a powerful effect in raising standards.

23. The FCA is likely to achieve greatest impact if it recognises that the great bulk of the population falls into the "mass market". This means that it should be possible to achieve many of the FCA's desired outcomes through intensive conduct regulation of a relatively limited number of product types, product providers and distribution channels. The "mass market" needs ready access to a range of generally fairly simple, good value products, together in some cases with straightforward advice.

24. It should also be borne in mind that for a significant proportion of households their key financial decisions relate more to management of debt rather than financial assets. For a variety of public policy reasons, attention should be paid to the relative impact on customer experience of acquiring debt, compared to building up savings, of both the regulatory system and financial firms' behaviour. At present for many consumers it is easier to acquire a credit card than to open a bank account, and it is far from clear that is appropriate. This issue should be taken into account in the decision to be made on whether to transfer regulation of consumer credit to the FCA.

25. The FCA will have difficult judgements to make regarding how intrusive its regulation should be. One difficult area is whether it should intervene if products sold to retail clients appeared to yield an "excessive" profit, after taking account of risk. A related issue is whether the FCA should intervene in commercial practices such as deposit-takers sometimes moving customers after a period of time to less advantageously priced "back books". Another issue is that it might be necessary to address the incentives provided by remuneration arrangements for customer-facing staff (and not just senior management) in some regulated firms.

Q4: *To whom should the FCA be accountable? Are the lines of accountability clear?*

26. *Recommendation:* In view of the importance of the FCA's responsibilities, ICAEW believes that there should be frequent accountability directly to Parliament. We would suggest that, at least for the first few years of the FCA's life, the Treasury Committee should hold quarterly hearings with FCA top management, focusing on the main challenges the FCA is addressing, together with a review of new or closed issues during the quarter in question.

27. It will also be important that a significant number of high-calibre people from outside the industry are appointed as non-executive directors on the FCA Board. Partly in order to raise public awareness, such non-executives should be encouraged to make public speeches on topical issues, along the lines of external members of the Monetary Policy Committee.

28. *Recommendation:* There are also steps which can be taken in relation to the internal governance which would strengthen accountability, especially in relation to greater application of judgement. For example, we believe that the FCA (and the Prudential Regulatory Authority [PRA]) should establish independent, internal Quality Assurance functions to provide an assessment of how judgement is being applied. It would also be appropriate for the regulators to establish a committee along the lines of the FSA's Regulatory Decisions Committee, with members independent of line-management regulatory decision takers, which would need to consent to judgement-based decisions above a certain level of materiality to a firm.

Q5: *Are the powers of the FCA suitable? Will their exercise be subject to appropriate scrutiny? How should the FCA be interacting with industry as well as using its intervention powers?*

29. The FCA needs powers to operate right along the product production chain, from product design to distribution. For that reason, we support the additional powers relating to product intervention and financial promotions, subject to appropriate rights of representation and appeal against the FCA's decisions. The product intervention power in particular will need to be used within a strong set of governance, accountability and transparency arrangements, especially to guard against claims for compensation from the FCA (or Government) with regard to products which were not banned but which nonetheless caused significant consumer losses.

30. We would hope that the industry will want to work co-operatively with the new regulator, not least as a high-level of consumer confidence in financial services would be in the industry's own interests. Intensive, structured contact with the industry should be an important source of information for the FCA.

31. In relation to wholesale markets, we welcome the proposed establishment of a FCA Markets Panel. In order further to recognise the distinction between wholesale and retail markets, the amended FSMA could require the FCA to "have regard" to relevant differences between these types of market, and that a minimum proportion of the FCA Board members have significant wholesale markets experience.

Q7: *How should the FCA be interacting with other domestic regulators? For example, the FCA's relationship with the Bank of England and Financial Ombudsman Service?*

32. The FCA's work should be informed by the Bank's macro-economic and financial stability analysis, and by the Bank's knowledge of the functioning of wholesale markets. Other domestic regulators, such as the Ombudsman service, are likely to be important sources of information regarding what is happening "on the ground" in retail financial services.

33. A variety of responsibilities for wholesale markets, and key firms which operate in them, will be allocated in the new regulatory structure amongst the Bank of England, PRA and the FCA. Effective co-ordination between these bodies will be of prime importance.

34. In retail markets there are important interactions between prudential and "conduct" issues. For example, capital and liquidity requirements affect costs which have to be recovered from customers. At the same time, conduct requirements affect the profitability of different business models, which could have prudential implications. Again, co-ordination among domestic regulators will be essential.

35. A particular way in which co-ordination between the FCA and the PRA would minimise compliance costs for firms would be to seek the greatest possible consistency of rulebooks, standards and regulatory processes, together with properly co-ordinated supervision of firms subject to both PRA and FCA regulation.

Q8: *How should the FCA be interacting with international regulators? Do EU regulation initiatives restrict or enhance the work of the FCA? Will the FCA be able effectively to engage with the EU supervisory authorities?*

36. In exercising its powers, the FCA should be mindful of risk that "excessive" UK regulation could cause business to shift outside the UK or EU, where there may be fewer regulatory protections for consumers. Clearly that risk is reduced the more other countries take a broadly similar approach to the FCA, which points to the desirability of harmonisation at least within the EU, provided that is done on the basis of robust standards.

37. Staffing decisions at senior technical and policy levels in the FCA should reflect the importance of building an organisation which will have the breadth and depth of expertise to command respect among regulators internationally.

October 2011

Written evidence submitted by the Consumer Credit Association

Executive Summary

1. Consumer Credit Association is the trade body for the UK's home-collected credit sector.[16] We very much welcomes the opportunity to respond to this inquiry.

Transfer of unsecured credit to FCA not in UK's economic interest

2. Our main concern is the proposal that unsecured credit should transfer from OFT to FCA. We think this would create a serious over-regulation risk[17] because FSA is a high-cost regulator.[18] As the Treasury Committee put it in February 2011:

> *"Inappropriate regulation of non-banking sectors could cause serious and unintended damage to companies within those sectors, and to the UK more widely."*

3. If unsecured markets had failed, we could see why more intense regulation might be needed. But all the robust studies show that (contrary to the media view) unsecured markets are stable and have worked well.

4. Over-regulation damages the competitiveness of markets. On transfer to FCA, we would expect to see market exit (especially by small traders), upward pressure on prices, reduced supply of credit and increased financial exclusion. This would all harm consumers, growth and the economy.

FCA should have a primary duty to promote competition

5. We strongly agree that—as the Committee suggests—FCA should have a primary duty to promote competition. We note that the ICB also recommends this.

FCA structures not being designed with unsecured credit in mind

6. The Government was right to consult separately on the transfer of credit from OFT to FCA. However, an unintended consequence is that the debate on FCA design is proceeding without real discussion on the implications for unsecured markets.

Detailed Response

Transfer of unsecured credit to FCA not in UK's economic interest

7. Our principal concern is the proposal that unsecured credit should transfer from OFT to FCA. The consultation argues this could improve coherence, oversight, flexibility and efficiency.[19]

8. However, the consultation overlooks the question of cost. We think this is the main problem and that it overshadows all other considerations. FSA and OFT spend at very different levels. FSA annual costs are c.£500 million (regulating c.25,000 firms). By contrast, OFT monitors c.96,000 traders for around c.£20 million–£30 million p.a..

9. Broadly, we think a move to FCA would drive up the regulatory cost/load of running an unsecured credit business in the UK by at least a factor of five.

10. Some argue that markets have failed, that OFT regulation is inadequate and that costs must rise to achieve improvements. We disagree for several reasons.

11. First, product differences make a clear case for differentiated regulatory treatment, as the table shows:

	Unsecured credit	*Investment, insurance, mortgage credit*
Credence goods?	No	Yes
Complexity (product plus legal rules)	Low	Moderate-high to very high
Risk to consumer	Low to moderate (per loan size)	Very high to moderate-high
Risk flow	Lender at risk	Consumer at risk
Small trader fee cost (OFT v FSA)	c.£1000 for five years (OFT)	c.£1000 for one year (FSA)

[16] A sub-set of the unsecured lending market

[17] The FSA paper of June 2011 ("*Approach to Regulation*") infers that FCA may have an approach that is even more interventionist and intense than FSA's.

[18] Our concern is strictly limited to unsecured credit. We accept that for other products, FSA-style regulation may be justified.

[19] See *"Consultation on reforming the consumer credit regime"*, H M Treasury/BIS, December 2010.

	Unsecured credit	*Investment, insurance, mortgage credit*
Mass market?	Generally, yes	Generally, no
Extant authorizations	c.96,000 (including brokers)	c.25,000

12. Second, some say that UK unsecured markets are dysfunctional and warrant FSA-style controls. In fact, the statistically-robust data[20] shows these are stable markets which, in general, have worked well for the consumers who use them:

> *"It is often assumed that the huge increase in the volume of consumer credit over the past ten years or so must have been accompanied by an increase in indebtedness. In fact there is so little information about the extent of debt that is difficult either to substantiate or contradict this conclusion."*
> Professor Elaine Kempson, 1992
>
> *"And I am interested because overindebtedness is a subject that frequently receives a great deal of press coverage reflecting anxieties about the level of consumer credit spending and the potential impact this may have on many households in society—not just the particularly vulnerable consumers…*
>
> *However—despite the increase in amounts owed—the MORI research found that most households used credit modestly. The majority have only one or two credit commitments. They owe modest amounts and pay less than a 10th of their gross income on credit repayments…*
>
> *…The MORI household survey provides us with a very balanced view and offers perspective on the use of credit. On the one hand, it shows us that, contrary to recent speculation, despite both the increase in available credit facilities and the increase in amounts owed, the majority of UK consumers use credit modestly. It is worth stressing again, that only a minority are heavy credit users."*
> Melanie Johnson MP, Consumer Minister[21]
>
> *"The survey provides evidence that the number of individuals taking on a high level of debt service has increased over the past two years, reflecting the strong growth in consumer borrowing. However, the evidence also suggests that this increasing debt service is not causing significant problems at present. The number of individuals who consider their household's borrowing to be a heavy burden is low and has remained constant over the past two years. The proportion of individuals in arrears on repayments on credit or domestic bills is also low."*

"Over-indebtedness in Britain: A DTI report on the MORI Financial Services survey" 2004.

> *"…Almost one-tenth (9%) of households were in 'structural' arrears.*[22] *There was little variation in this measure over the period of the survey but some indication that the proportion of households in arrears may have peaked between October 2008 and February 2009…"*

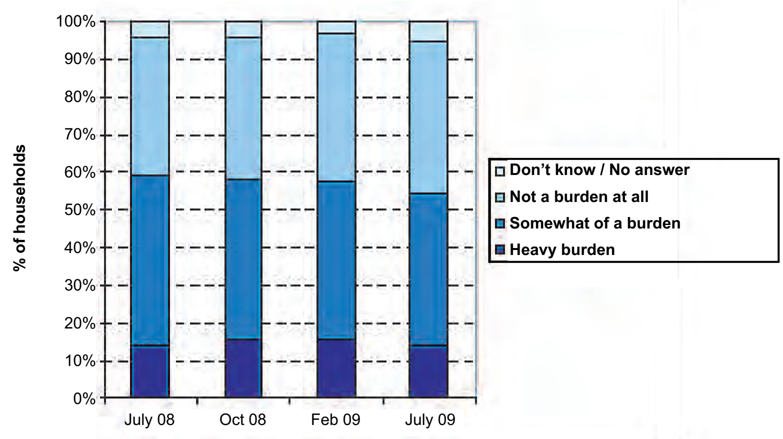
"Over-indebtedness in Britain: second follow-up survey" (BIS) 2010.

[20] A series of statistically-representative studies and surveys which really began to emerge from 2002 onwards, starting with Kempson's *"Over-indebtedness in Britain: a report to the DTI"* Kempson [2002]. Other key studies include NACAB/MORI (2003) [*sample: 1,986*]; CCCS (2003) [*sample: 50,000*]; DTI/MORI (2004) [*sample: 9,892*]; Bank of England burden-of-debt data for years 2003, 2004, 2006, 2008 and 2009 [*based on BHPS and NMG data*]; CCCS (October 2009) [*sample: 18,596*] and DTI (2010).

[21] Comments at the launch on 27 November 2002 of *"Over-indebtedness in Britain: a report to the DTI"* Kempson [2002]

[22] That is, more than three months behind on any bill or payment. Note that this 2010 BIS survey report does not disaggregate credit bills (on the one hand) and household bills such as utility bills (on the other hand) but treats them as a composite. By contrast, the 2004 DTI report and Kempson's 2002 study both separate out the two distinct categories of debt. We think it is only possible to analyse a credit market if credit debt is separated out from other debt. Some utility bills are also routinely not paid by users. For instance, figures from 2006 suggest that around 15% of water customers never pay their bills.

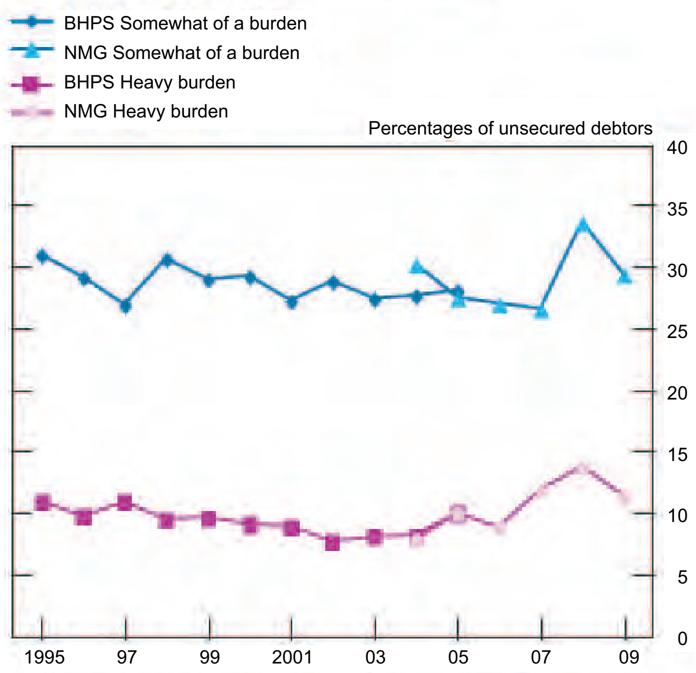
Figure 5.4: Extent to which keeping up with bills and credit commitments is a burden - all households



"Over-indebtedness in Britain: second follow-up survey" (BIS) 2010.

Bank of England surveys echo these findings, suggesting that over the last fifteen or so years, the percentage of UK credit users who find their debts "a heavy burden" has stayed at a fairly constant, fairly low figure:[23]

Chart 9 Burden of unsecured debt (a)



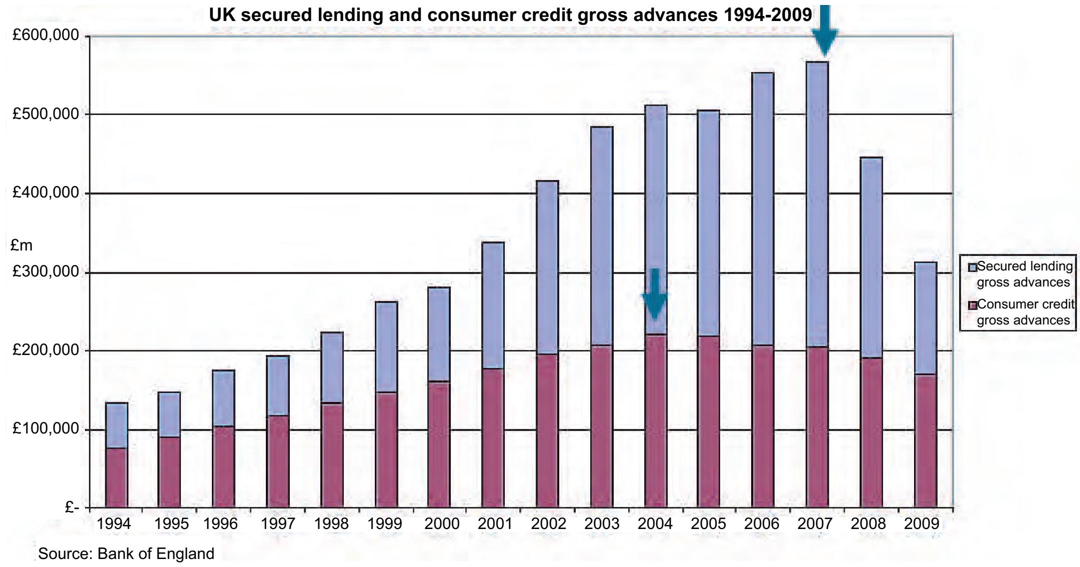
Sources: British Household Panel Survey, NMG Financial Services Consulting survey and Bank calculations.

(a) Question: 'To what extent is the repayment of these loans and the interest a financial burdern on your household

Finally, unexpected life events (eg job loss or divorce) cause most debt problems. No amount of regulation can prevent these from occurring.

[23] The Bank's commentary says the 2008 blip in the graph was down to a sudden spike in utility costs.

13. Third, some infer that unsecured lending is out of control and that this supports a case for more intense regulation. In fact, Bank of England figures show that gross advances (flow) into the UK unsecured market began to fall in 2004, well before the crisis. Adjusting for inflation, flow in 2009 was in fact back down to 1998 levels:



14. Other factors point to the correctness of keeping credit regulation with OFT. As well as the key role played by the Trading Standards Service (a joint enforcer of UK credit law), there is a natural "fit" between the supply of consumer credit and the goods and services it is used to purchase. The reality is that only about 5% of the 96,000 or so OFT credit licence holders supply credit in their own right. Most are retailers of some type (eg shops).[24]

15. The unsecured sector is integral to many parts of the real economy, with many sectors depending for their existence on a ready supply of credit that their customers can use to buy their products. The figures are large. At the end of 2009, unsecured credit balances totalled £227 billion. During 2009, unsecured gross advances (flow) were £171bn (c.12% of GDP). If the UK gets credit regulation wrong, the effects on the economy could be serious.

FCA should have a primary duty to promote competition

16. We strongly agree that—as the Committee suggests—FCA should have a primary duty to promote competition. We note that the ICB also recommends this.

17. The ICB puts it in terms that regulation can, in fact, obstruct competition. We think the current text of the draft Bill would have this result, because it subordinates promotion of competition to other matters.

18. The Committee asks how a duty to promote competition might work. Although we have only passing knowledge of the position in the US, it seems to us that the thrust of US law is on promoting honest competition. The method the law seems to use to achieve this is to outlaw *"unfair methods of competition"* and *"unfair or deceptive acts"*.

19. We gather that the new Consumer Financial Protection Bureau in the US has attracted controversy, with some voices arguing that there is a serious risk that it will over-regulate US credit markets.[25] However, we have looked at the purpose and objectives[26] of this new body and they may be of interest:

> *PURPOSE: The Bureau shall seek to implement and, where applicable, enforce Federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive.*
>
> *OBJECTIVES: The Bureau is authorized to exercise its authorities under Federal consumer financial law for the purposes of ensuring that, with respect to consumer financial products and services:*
>
> > *(1) consumers are provided with timely and understandable information to make responsible decisions about financial transactions;*
> >
> > *(2) consumers are protected from unfair, deceptive, or abusive acts and practices and from discrimination;*

[24] Who must hold an OFT credit broking licence if they intermediate credit.

[25] And with others arguing that it will lead to the important body of consumer protection and economic knowledge built up within the Federal Trade Commission over the last 90 years being overlooked.

[26] See Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010.

> *(3) outdated, unnecessary, or unduly burdensome regulations are regularly identified and addressed in order to reduce unwarranted regulatory burdens;*
>
> *(4) Federal consumer financial law is enforced consistently, without regard to the status of a person as a depository institution, in order to promote fair competition; and*
>
> *(5) markets for consumer financial products and services operate transparently and efficiently to facilitate access and innovation.*

FCA structures not being designed with unsecured credit in mind

20. The Government was right to consult separately on the transfer of credit from OFT to FCA. However, an unintended consequence is that the debate on FCA design is proceeding without real discussion on the implications for unsecured markets.

Miscellaneous

21. It has been suggested that principles-based rulebook systems (eg FSA rulebooks) will promote growth because they are more helpful to financial service providers than statute law systems. We can see that this might be true for (a) complex non-credit products and for (b) large-ticket secured lending. We do not think this holds good for unsecured, mass-market credit. Here, suppliers need certainty, simplicity and stability to allow them to build and operate the high-throughput systems required to serve these unsecured markets efficiently. The experience of principles-based rulebook systems in the UK and elsewhere suggests that they are volatile and unpredictable.

22. The Committee asks for views on accountability of FCA. Our impression is that, *in reality*, FSA has only limited accountability. This raises important constitutional concerns, because FSA has been able to function as a law maker, through its rule-making function. There is little or no scope for any democratic scrutiny of this *corpus* of soft law.

October 2011

Written evidence submitted by AGE UK

Executive Summary

— Age UK broadly welcomes the draft Bill and in particular the direction of travel towards a more proactive consumer protection approach. We have the following principle concerns in respect of the Financial Conduct Authority.

— (FCA)The FCA's strategic objective must not override the operational objective of consumer protection.

— The FCA needs a clear vision of a competitive financial services market focused on consumer outcomes.

— The FCA must also recognise the limits to competition in this sector and needs powers to ensure access to essential services.

— The Committee should consider whether the FCA should have particular regard for "vulnerable" consumers.

— Culture and approach must be underpinned by legislation and not seen as replacements for clear objectives and powers.

— Consumer protection is a package and changes to individual aspects should be tested for their impact on the effectiveness of the whole.

Q1: *Are the objectives of the Financial Conduct Authority (FCA) clear and appropriate?*

— The objectives of the FCA will not provide the regulator with clear direction and do not give appropriate weight to consumer protection and access. The variety of functions (consumer protection, markets and prudential) allocated to the FCA creates tension in drafting an overriding strategic objective. The strategic test of "protecting and enhancing confidence in the UK financial system" makes the appearance of confidence more important than the reality of a sound financial system. Protecting and enhancing confidence is largely in the control of the participants in the system. If participants act irresponsibly then the regulator needs to be able to alert consumers and take enforcement action. The current drafting suggests that the FCA should not do this if it would damage confidence in the UK financial system. Instead the FCA needs to be able to pursue longer term sustainability even at the cost of a short or medium term drop in confidence in one particular area.

— In order to bring clarity, Part 1A should be amended so that it is clear that the strategic objective is pursued only to the extent it is consistent with the operational objectives.

Q2: *Should the FCA have a primary duty to promote competition as recommended by the Treasury Select Committee and Independent Commission on Banking? How should this work in practice?*

— We agree with the Treasury Select Committee and Independent Commission on Banking that the "choice and efficiency" objective does not go far enough to ensure a competitive financial services market. However strengthening the objective alone is not enough.

— First, the FCA will need a clear vision of what a competitive financial services market should look like. This should be focused on consumer outcomes such as value and fair treatment. This goes beyond increasing the range of products available—a US study looking at the impact of choice on participation in 401(k) plans found that other things being equal, every ten funds added to a plan reduced participation between 1.5–2%.[i]

— Second, the FCA must have powers to achieve its objective. As a minimum this must include a power for the FCA to conduct market studies and amendments to s348 of the draft Bill so the FCA can increase market transparency. The regulator must also have a clear mandate to consider value for money. This need not result in price caps, but could involve the regulator using transparency, for example through rules similar to "RU64" which could require firms to justify higher priced products to consumers. Value for money is about more than price and a range of benchmark products (whether simple, straightforward or trustworthy) could improve consumer's ability to choose. The FCA should have powers which would allow it to play an appropriate role, including establishing, monitoring and enforcing rules around benchmarking.

— Third, the legislation must recognise the limits of competition, particularly for consumers who are not attractive to providers or because who are unable to exercise effective demand (which may be because they are "vulnerable consumers"). Addressing the limits of competition will enable clarity in what competition can achieve for consumers.

— The FCA therefore also needs an objective to ensure access to essential financial services. Some financial services are essential services to which consumers must have access in order to participate fully and independently in UK society. We already see examples of additional cost to the state as a result of the failure of mainstream provision to meet the needs of certain groups. For example, some Local Authorities are choosing to procure prepayment cards in order to deliver direct payments of social care budgets.

— Access to essential services should be seen as more than access to a basic bank account. The recent cheques saga is a prime example of the consequences of the absence of access regulation. The banks, through the Payments Council, were able to unilaterally announce a target closure date and take other actions to undermine the cheque. No regulator or other institution was able to intervene and there is still no one with the power to ensure that cheques remain available. It is unacceptable that vital infrastructure can be mismanaged in this way. Cheques are unusual in that the public was mobilised to campaign to save them, however payment systems and other financial services are more often intangible and opaque and public pressure cannot be expected to monitor them.

— Regulators in other sectors (such as energy, water and telecommunications) commonly require firms to take special measures to ensure "vulnerable" consumers have access to essential services. There is no single definition of a "vulnerable" consumer, however descriptions commonly include people with disabilities or who are chronically sick, older people and people on low incomes.[27] Postcomm must also have regard to those living in rural areas. We would welcome the Treasury Select Committee's views on whether the FCA would benefit from a statutory duty to have regard to "vulnerable" consumers. Of course not all older people are vulnerable consumers and some are very effective purchasers of financial services. In the same way, many people who do not fall into any group commonly described as "vulnerable" can struggle to make good choices in the financial services sector. Because of the challenges to achieving effective consumer demand in financial services, particularly information asymmetry and one-off long term purchases, a different description of "vulnerability" may be necessary.

— We agree that access for all and any special provisions for vulnerable consumers are social policy issues which should be set by the Government, however the regulator has a vital role in implementing change. Services classed as essential could be specified by an order by the Treasury which would ensure that social policy remained the preserve of Government.

[27] For example Ofgem, Ofwat and Postcomm are required to have regards to consumers with these types of "vulnerability".

— Access to banking in rural areas is an increasing concern. The Chancellor has recently announced measures to ensure that mobile phone coverage reaches areas which are not profitable for mobile phone providers, yet there is relative silence on the bank branch network. The reduction in the branch network will further reduce competition and choice for consumers in rural areas who cannot always easily travel to their nearest branch, let alone to a branch of their preferred bank. Branch access will remain vital for older people for many years to come: 58% of people aged over 65 have never used the internet[ii] and just 26% of people aged 75+ have internet access at home.[iii] With 10% of those aged 75+ saying they have very difficult access to a corner shop, distance matters.[iv] A more creative vision of competition could address these concerns. Shared branches offer a perfect competitive environment, with ease of comparison and switching in one customer friendly location. The Bill should permit the FCA to monitor, make recommendations to Government and implement the fundamental reforms that are needed to achieve a truly competitive financial services market.

— We would also welcome the Treasury Select Committee's consideration of a financial access code. This could be set by the Treasury, with the FCA required to have regard to it in the operation of its functions. The more flexible nature of a code may permit the Government to pursue a broader range of access objectives.

Q3: *Does the FCA's approach to regulation, as outlined in the Financial Services Authority (FSA)'s June 2011 document, represent an improvement on that of the FSA?*

— The FCA's approach to regulation is a continuation of improvements already visible within the FSA. Whilst we welcome the improvements and the emphasis on culture and approach this must be underpinned by the legislation. For example, culture and approach are not substitutes for clear objectives and powers.

Q5: *Are the powers of the FCA suitable? Will their exercise be subject to appropriate scrutiny? How should the FCA be interacting with industry as well as using its intervention powers?*

— It is important to consider the consumer protection provisions as a whole, as well as scrutinising individual elements, such as product intervention. We are concerned that during the progress of the Bill there will be calls to water down specific sections which may seem insignificant alone, but when put back together mean that there are significant gaps in protection. For example, the FCA could have appropriate objectives and powers but be incentivsed against enforcement if it is too easy for firms to challenge decisions.

— Product Intervention: We support these powers. They minimise uncertainty for firms and have the potential to protect consumers. We accept that they may reduce choice for consumers, however we believe they will promote good choice and confidence in the market.

— Transparency: Transparency is a pre-requisite for competition. If consumers are expected to take responsibility for their choices they must have information in a form which allows them to make sound decisions. The proposed provisions should be strengthened by an amendment to s348 of the draft Bill so that it is clear that the FCA will be able to use transparency as envisaged in the regulatory principles. As all firms are subject to the same transparency requirements the market should adjust to the new disclosure regime.

— Oversight: Until recently, the FSA appears to have taken a cautious approach to enforcement action. As FSMA gives the FSA wide discretion to make determinations it is likely that the caution has arisen as a result of fear of challenge. The historic approach of the FSA resulted in inadequate consumer protection. We are therefore pleased to see in clause 20 the proposed change to the Tribunal powers. This change will ensure that the FCA is held accountable for making sound determinations, but will mean that the Tribunal does not play the role of regulator in specifying outcomes which the FCA is better placed to make.

— Interaction with industry: The FCA should of course continue to engage with both industry and consumer groups as well as using its powers. It will be appropriate for the FCA to evaluate the impact of its new powers and approach. However the role of the FCA is to regulate not to negotiate or arbitrate between the two. The FCA will need to consider how to achieve a timely evaluation. Although lessons can be learnt on an ongoing basis perspective and a reasonable sample of actions will be necessary to provide a balanced assessment of the new regime. The FCA's interaction with both industry and consumer groups must therefore avoid piecemeal and unbalanced discussions which result in long term changes.

Q6: *How will the break-up of the FSA work in practice? Issues of coordination and information sharing between the FCA and the Prudential Regulation Authority (PRA)*

Q7: *How should the FCA be interacting with other domestic regulators? For example, the FCA's relationship with the Bank of England and Financial Ombudsman Service*

— The FCA nature of interaction varies significantly according to the body. Common elements are use of information received and ensuring that the other bodies understand and take into account the impact on consumers and market. We remain concerned that the FCA may be able to raise consumer issues with the PRA and FPC but there is little to ensure that the PRA and FPC give them due consideration. By contrast, we welcome the obligation placed on the FCA to consider data received by FOS and the Money Advice Service. The consumer and practitioner panels must be given powers to advise the PRA as well as the FCA.

October 2011

References

[i] Sheena Iyengar et al, "How much choice is too much?" Contributors to 401(k) retirement plans (Philadelphia: Pension Research Council, 2003)

[ii] Internet Access Quarterly Update Q2, ONS, August 2011 and mid-2009 population estimates, ONS 2010

[iii] Communications Market Report: UK, Ofcom, 2011

[iv] National Transport Survey 2010, Department for Transport, 2011

Written evidence submitted by the British Bankers' Association

Introduction

1. The British Bankers' Association welcomes the opportunity to respond to HM Treasury's Select Committee Inquiry into the Financial Conduct Authority.

2. The BBA is the leading association for the UK banking and financial services sector, speaking for 220 banking members from 60 countries on the full range of UK and international banking issues and engaging with over 40 associated professional firms.

3. We are grateful to the FSA for providing greater background on its view of how the FCA might operate, going forward, in their paper *The Financial Conduct Authority—Approach to Regulation (June 2011)* (referred to below as the FSA paper), which augmented the HM Treasury paper (including a draft bill) *A New Approach to Regulation—The Blueprint for Reform (June 2011)* (referred to as the HMT paper). Clearly, the underpinning legislation has yet to be passed through Act of Parliament and as such we recognise that there is an element of fluidity in the FSA paper and the underlying (draft) Financial Services Bill.

Are the objectives of the Financial Conduct Authority (FCA) clear and appropriate?

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

5. We see this as entirely consistent with the objectives set for the three European Supervisory Authorities under recital 9aa of the regulations applicable which require that in each case the authority should take due account of the impact of their activities on competition and innovation, global competitiveness, financial inclusions and the strategy for jobs and growth.

6. The OECD is also consulting on consumer protection principles and for completeness, we would add that these should be included as part of the FCA regime in so far as possible.

Should the FCA have a primary duty to promote competition as recommended by the Treasury Select Committee and Independent Commission on Banking? How should this work in practice?

7. We have no difficulty with the emphasis in the FSA paper on applying its competition objective to: remedy asymmetries in market power and information; promote informed choice and market efficiency; and focus its action on particular identified market failures.

(a) However, different approaches are required for wholesale and retail markets. In particular regarding how the product information aspect could facilitate informed consumer choice. FSA's intended intelligent analytical approach to the use of regulation to foster useful competition is welcome.

8. We concur that the promotion of competition should be a secondary duty and that the FCA should be obliged to discharge its functions in a way which promotes competition, in so far as this is compatible with its primary objectives.

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

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

(c) It would be preferable to have an understanding of the roles of the OFT or the Competition and Markets Authority, and for those roles to have bedded down, before deciding on what role the FCA will also play in competition analysis and enforcement.

(d) The FSA paper suggests that the FCA will see its competition mandate as going beyond behavioural features and extending to structural features. The limits of this are quite unclear: for example, could the FCA vary a firm's permission in the interests of advancing its efficiency/choice objective, so as to achieve structural changes to a particular market.

(e) We are also concerned about the significant disparities in the legal processes and accountability mechanisms applicable to the FCA's use of its powers in this area as compared with those of the OFT and other competition authorities.

Does the FCA's approach to regulation, as outlined in the Financial Services Authority (FSA)'s June 2011 document, represent an improvement on that of the FSA?

9. We welcome the fact that the FCA will recognise that there are important differences between wholesale and retail markets but also that there are important links that could pose risks to confidence in the UK financial system.

10. It is critical for the industry that the FCA's actions—amongst other things first, provide regulatory certainty and second, avoid retrospection. Certainty within the operating/ regulatory environment is a key strength of the UK financial markets and new legislation should seek to ensure continuity of this approach. We will be looking to the FSA and FCA to demonstrate explicitly how they will be addressed, going forward.

11. The FSA paper explains that the term "consumer" will in future be a broad one but nevertheless says that the FCA will recognise the differences across "the spectrum" of this wide definition. What is clearly needed is a more detailed analysis of various current FSA Handbook glossary definitions (eg consumer, customer, banking customer) and how they might be affected in different ways by the FCA's regulatory approach.

12. We would be interested to learn more regarding how the FCA might be able to intervene in the relationships between providers and distributors, and how this might extend even further within the supply chain or where financial services providers distribute products and services outside the FCA's regulatory ambit.

13. The thinking around appropriate information appears to follow the FSA's conduct-of-business strategy which could be helpfully enhanced by greater clarification of the direct linkages between rules and principles—and what more is expected of a firm beyond rule-based compliance.

14. The proposed test for the provision is consumer-led (…*so that they can consider the implications for their personal situation and make an informed decision*…) and it would be helpful to better understand how this might be applied in practice.

15. We welcome the recognition of the need for consumer responsibility but see a need for the legislation to set out what this entails with greater clarity; equally, we would welcome clarification of how consumer responsibility will be a factor in FCA thinking, including the forensic market scrutiny envisaged by the business and markets analysis team, beyond the emphasis that "consumers" should take responsibility for informed decisions.

16. We agree with the explicit recognition that trade-offs between the interests of different market users are inevitable. As FSA notes, judgment, taking careful account of these trade-offs, will be essential. They may change over time due to changes in the level of, for example, acceptable risk tolerance, and we would therefore urge that judgments are reviewed regularly within and across different markets.

17. When considered in the round with the FCA's other more proactive intervention powers, the lack of any "kite-marking" or similar may lead to very risk-averse behaviours which in themselves can under-serve consumers generally. We would be keen to explore whether there are other means beyond product approval that give greater legal and regulatory certainty in an environment where the FCA itself acknowledges that it is possible that the FCA might make incorrect judgments.

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

19. The FSA paper confirms that the FCA will not be an economic regulator in the sense of prescribing returns for financial products or services.

20. The FCA's secondary "competition duty" therefore should not translate into the FCA seeking to measure and mandate what the correct price of a product should be—and it would be entirely inappropriate for the FCA to make "value for money" judgments that had this effect.

21. Price intervention is a hugely powerful tool and we would be keen to have a much better understanding of the methodology around pricing analysis to enable us to make informed comment.

22. Too great a focus on transparency and on price may lead to standardisation of products, the stifling of competition, and disincentives to innovate. Members are concerned that the FCA should not work towards a market with simple, highly comparable products in the mistaken belief that this will deal with both consumer and competition concerns.

23. The agenda as laid down in draft legislation and both the HMT and FSA papers is ambitious and as a consequence, presumably does not come without significant additional cost: We are keen to understand the cost-implications at an early stage.

24. The FSA paper does not cover proposals around the FCA's communications strategy; we would encourage the FCA to consider/ consult on its communications strategy to relevant stakeholders, including regulated firms, other regulators, consumers etc. as it is an integral component of the FCA's desire for transparency and disclosure.

25. The FSA has already stated publicly that it does not see a role in setting social policy, but the paper does not articulate how it will avoid this role, through the consequences of the actions it takes—or when this is inevitable (for example through restrictions to home loan provision affecting housing policy) the overarching justifications for the intended approach.

To whom should the FCA be accountable? Are the lines of accountability clear?

26. The intention is that the Chair of the FCA be appointed by HMT. We would like to see the Chair being an independent non-executive director.

27. We welcome the confirmation in paragraph 2.129 of the HMT paper and paragraph 4.17 of the FSA paper that the FCA will be obliged to investigate and report on regulatory failure since sensible use of the findings, complementing market failure analysis, is important to ensuring that scarce FCA resources will be properly targeted.

(a) Clauses 51(1) and (2) of the Financial Services Bill succinctly details the circumstances in which the FCA is required to investigate and report to the Treasury.

(b) We agree that the FCA should investigate situations where market failure has occurred and attempt to use this to learn lessons and implement remedies.

(c) We note that the circumstances for a report include where events have not actually led to a "*significant*" negative outcome but "*could have had*". Therefore, the draft legislation has a concept of near misses where the FCA is required to initiate an investigation which we welcome.

(d) Unless a separate team is charged with conducting a review the independence of this report could be compromised. In the interests of transparency and objectiveness our members believe that investigations of regulatory failure should be prepared by an independent body although measures would have to be implemented to take into account concerns regarding confidential information about firms.

Are the powers of the FCA suitable? Will their exercise be subject to appropriate scrutiny? How should the FCA be interacting with industry as well as using its intervention powers?

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

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

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

(c) Publication of Warning Notices—we consider that regulators should be transparent and consistent in their decision-taking process. To further transparency, we suggest that the FCA's criteria and assessment process when determining (i) what; and (ii) when, to publish should be set out to expand on the provisions of the Financial Services Bill, along the lines of the Banking Liaison Panel, established under the Banking Act (2009). Warning notices will likely carry a significant reputational impact and as such, it is critical that appropriate safeguards are introduced.

(d) Furthermore, in the interests of market clarity, we suggest that publicly disclosed information relating to Warning Notices should be accompanied by an explanatory statement, suitable for retail clients. This statement would ensure that retail clients correctly understand the meaning of such a notice. If this proposal is accepted then we would wish to see consultation on a draft as soon as possible.

29. At present the Financial Services and Markets Tribunal (FSMT) has the ability to supplant an FSA decision. Under the new regulatory structure the FSMT, however, other than with regards to *"disciplinary matters and those involving third party rights"* (White Paper Paragraph 2.66), it will lose this power and will only be able to refer the decision back to the FCA for further investigation. We have questioned why the Government considers that changing the existing role of the FSMT is required.

30. We welcome the confirmation given in paragraph 4.1 of the FSA paper that it is not envisaged that the FCA's more interventionist stance will lead to a major change from FSA's existing regulation of non-retail markets. We welcome the proposed intelligent analytical approach to determining whether risk is transmitted to retail "consumers" from wholesale markets, set out in FSA paper paragraphs 4.6 and 4.7.

31. We would be grateful for clarification of the circumstances where there would be reason for the FCA to intervene *in the interests of the wider economy.*

32. We can see merit in a new approach to identify potential issues earlier, however as part of the FCA's communications strategy it would be inequitable (and ultimately destroy shareholder value) if any reservations identified by the FCA in one firm were not provided to other firms at an early stage to enable them to review their own products to ensure they are not subject to similar issues. This is particularly important where firms do not fall within dedicated relationship management.

33. Acknowledging the need for the FCA to make judgmental trade-offs, we consider it to be vital that there are ample formal and informal opportunities to challenge and inform the FCA's decision making process.

34. While we remain doubtful of the merits of the proposed publication of disciplinary action, we welcome the safeguards surrounding the powers of the FCA on early publication of disciplinary action, and the obligation to consult the person to whom a notice is given. As a guiding principle we would strongly support any challenge process that is built into the resolution mechanism early, i.e. before a scheme or similar is developed.

How will the break-up of the FSA work in practice? Issues of coordination and information sharing between the FCA and the Prudential Regulation Authority (PRA).

35. We welcome the statutory obligation for the FCA and PRA to coordinate and the provisions on maintaining its content and public accountability for its use.

(a) We encourage the MoUs to be developed as soon as practicable and welcome the proposal that regulators review MoUs at least annually and would further recommend that this be as part of a consultative process.

(b) We also look forward to publication by the Bank of England and FSA of plans on operational co-ordination later this year and again would underline the importance of consultation upon this document.

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

(a) We welcome the Government's commitment for a simplified process on authorisation with one regulator taking the lead with processing an application. We have also encouraged the Government to take a similar streamlined approach to the approved persons application process and variations in permission.

(b) We support the view that where one group firm is PRA authorised, the PRA should be the prudential regulator for all group firms. This is by far preferable to the alternative approach set out in the Treasury blueprint document

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

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

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

(a) On a wider point, we are also concerned that credit regulation is not being considered as an integral part of the formation of the FCA. In principle, a single regulator for financial services, including consumer credit, with the FCA fulfilling that role, is welcome.

(b) However, the suggestion that the Consumer Credit Act (1974)—though not perfect should be re-written as a principles-based rule book will be a huge, expensive and disruptive project for the FCA and stakeholders and the same outcome could be achieved by incorporating the present CCA and existing regulations as new regulations under FSMA, making necessary amendments for the role of the FCA.

How should the FCA be interacting with other domestic regulators? For example, the FCA's relationship with the Bank of England and Financial Ombudsman Service

40. We agree with the Bank of England being given the regulatory responsibility for the regulation of settlement systems and recognised clearing houses, alongside its existing responsibility for recognised payment systems, but see a need for an MOU with the FCA given what looks like a significant overlap in interest. Drawing from HM Treasury's earlier paper, *Building a Stronger System,* the areas that the MOU might cover could include:

(a) linkages with RIEs and other trading platforms regulated for both prudential and conduct purposes by the FCA;

(b) in relation to self-clearing exchanges (ie RIEs that also provide their own clearing facilities as a central counterparty) and groups which include separate RIEs and RCHs;

(c) UK representation in ESMA (in which the FCA will represent the UK); and

(d) any conduct of business issues relating to central counterparty RCHs.

41. Effective coordination between the new regulatory bodies is essential and we look forward to publication of further details of how this will be achieved. It is important for regulators to agree a cohesive approach to high profile issues such as forbearance to avoid potential conflict with other initiatives. We have already seen evidence of the importance of this with the FPC recommending at its first meeting in June that the FSA extend its review of mortgage forbearance, without referring to the recent FSA consultation on the subject.

42. There is some concern over the veto powers available to the PRA over the FCA: these appear to mean that there is no requirement for the PRA to consult with the FCA if it is "of the opinion" that there is a threat to the UK financial system. It is important that the FCA is not seen as a "junior regulator" in this regard. Any disagreements over the use of this power should be resolved efficiently and privately to avoid reputational damage to both the regulators and the new regime.

43. Whilst the FSA paper does not cover the coordination of crisis management, we would expect to see the FCA playing a key role, for example, in protecting consumers and communicating key consumer focused messages. In our response to HM Treasury, we have suggested the creation of a COBRA-style committee and we believe the FCA should be represented on this.

44. We are concerned that the proposal around "mass detriment" in HM Treasury's white paper omits a critical issue. It is unclear whether mass detriment must be premised on the FCA considering that there has been some form of compliance failure (ie failure by firms to comply with the rules) or whether it could also arise from market failure (ie firms are complying with the rules but the market is not operating in a way that produces sufficient benefits for consumers).

45. At present, there are four different statutory tests for consumer redress: three in FSMA and one in DISP. We therefore see a case for the statutory regime to be strengthened in the following respects:

(a) To reinforce the role of the FOS of making decisions based on the circumstances of individual cases;

(b) To reduce the scope for protracted disputes that complicate the handling of complaints, by enabling decisions as to the appropriateness of a firm's business practices (affecting a large number of complaints/ potential complaints) to be referred at an early stage to the Upper Tribunal; and

(c) To incentivise CMCs to operate in a way that assists the resolution of genuine complaints, by enabling the FOS to impose requirements on CMCs as well as consequences where those requirements are not met.

46. In principle we are not averse to a scheme similar to the "super complaints" process under the Enterprise Act (2002) which has been used in financial services on a number of occasions and is now well-established.

47. The new regime will use FOS for intelligence gathering. Although the proposed statutory duty on FOS (and other parties) to refer to the FCA specific matters may be a more expeditious approach than current arrangements, it will be important to ensure that firms are able to make representations to FCA while FCA considers matters referred to it by FOS.

(a) Although we welcome FOS's comments that it will further guidance in autumn 2011 on how it determines decisions, we would highlight that the role of the FOS as a quasi-regulator remains a real concern, especially as it will not be subject to the same levels of accountability that will exist for the FCA and PRA.

How should the FCA be interacting with international regulators? Do EU regulation initiatives restrict or enhance the work of the FCA? Will the FCA be able effectively to engage with the EU supervisory authorities?

48. We welcome the priority the FSA paper being given to engagement with Europe, particularly ESMA. Given:

(a) the FSA's expertise in wholesale market regulation;

(b) the significance of wholesale markets to the proposed FCA objectives;

(c) the importance of ensuring that ESMA's rule-making and policy and supervisory coordination is consistent with those objectives;

(d) the importance of ensuring that ESMA's work is fully informed and influenced by appropriate differentiation between different markets and different types of "consumer", and

(e) the importance of imbuing ESMA with the policy and rule-making disciplines described in paragraph 5.33, we would like to understand in more detail how the FSA plans to carry forward the FCA's engagement with ESMA.

October 2011

Written evidence submitted by Bluefin Insurance Services Limited

1. Bluefin Insurance Services Limited is authorised and regulated by the Financial Services Authority as a general insurance intermediary for the sale of general insurance products and services. With offices nationwide, Bluefin is one of the largest independent insurance brokers in the UK and using significant influence and buying power on behalf of its clients. Bluefin is a member of the AXA group, one of the largest hundred companies in the world.

Executive Summary

2. As proposed in HM Treasury's consultation document "A new approach to financial regulation: the blueprint for reform", Bluefin Insurance Services Limited would be solely regulated for prudential and conduct of business matters by the Financial Conduct Authority (FCA). We would wish that to continue to be the case and including issues such as authorisation, variation and removal of permissions, the regime covering approved persons and the making and waiving of rules.

3. We were concerned to read in the recent FSA paper, Financial Conduct Authority Approach Document, the phrases "considerable investment in resources…..needed" and reference to new units such as "a senior level, high quality, business and market analysis team". We do not believe that insurance intermediary supervision by FSA has failed or that there is evidence of a need to mend a failure in this respect. We would respectfully comment that any increased fees or levies should be proportionate, appropriate and cost-effective in relation to the specific service which insurance intermediary firms will receive from the FCA.

4. We would also take this opportunity to comment here on the Financial Services Compensation Scheme (FSCS) as there does not seem a more appropriate point in the question set presented. We believe that two issues are essential in respect of FSCS and should not be overlooked during the development of the FCA. First, any cross-subsidy between different types of regulated firms should cease and in particular, insurance brokers should not be at risk of funding compensation required for the banking sector. Second those full-time, professional, insurance brokers should be separated from other, secondary sellers of general insurance currently in the FSCS's insurance intermediary sub-class. We are pleased to note the FSA's announcement of 03/10/2011 of their decision to restart the FSCS funding review and that FSA hopes to open formal consultations in the first half of 2012. Therefore and hopefully, these changes will be effective before the FCA is operative but they still should be noted.

Questions

1. *Are the objectives of the Financial Conduct Authority (FCA) clear and appropriate?*

5. We believe the objectives to be clear and appropriate at a strategic level. However we wish to see at the tactical level of individual supervision of insurance intermediaries of which we are one, that the objectives will be achieved in a proportionate, appropriate and cost-effective manner. Insurance intermediaries have been regulated from 2005 upon the implementation of the Insurance Mediation Directive. We therefore joined a mature regulatory regime which FSA had been developing since 2000, inheriting elements of previous regulators' regimes going back a number of years prior to 2000. We have on occasions felt that rules have been designed for the higher risk financial activities of other types of financial firms and then, lower risk firms' activities such as our own are "shoe-horned" into such rules. This does not make for a proportionate and appropriate supervisory regime.

2. *Should the FCA have a primary duty to promote competition as recommended by the Treasury Select Committee and Independent Commission on Banking? How should this work in practice?*

6. Yes, healthy competitive markets are a significant contributor to consumer protection. They need to be underpinned by adequate rules and regulations to constrain those who would abuse their position to treat consumers unfairly. Such constraints are also to the advantage of market participants in creating a "level playing field" for legitimate competition to flourish. FCA should establish a process for balancing the need to support healthy competitive markets whilst punishing those poor practices which could lead to consumer detriment. These are not mutually exclusive objectives but are two means by which to achieve the primary duty to promote competition.

3. *Does the FCA's approach to regulation, as outlined in the Financial Services Authority (FSA)'s June 2011 document, represent an improvement on that of the FSA?*

7. As mentioned above, we do not believe that insurance intermediary supervision by FSA has failed or that there is evidence of a need to mend a failure in this respect. However, we have concerns in respect of the proposed new power in relation to publishing warning notices.

8. This has the potential to cause serious harm to a firm's business reputation. Discretionary authority granted to the FCA as to when not to publish a warning notice even if discussed with the firm in question prior to publication, is not a sufficient check or balance. We also note that the FSA's recent memorandum to the Joint Committee on the Draft Financial Services back-peddles on this relatively mild check or balance of involving the firm in question, as they say, to avoid the risk of the firm disagreeing with publication.

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

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

11. We also have concerns in relation to the definition of "consumer". The suggestion that this would include other regulated or exempt firms whilst carrying out regulated activities and as part of a chain leading to the ultimate customer of a financial service or product.

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

13. Those practitioners in a chain leading to the policyholder are subject to regulation. They are required to be competent in managing the services and products they offer so the additional protection usually granted to a policyholder or prospective policyholder, is unnecessary and inappropriate to their role.

4. *To whom should the FCA be accountable? Are the lines of accountability clear?*

14. We believe that the proposals to make the work of the FCA accountable to the public via Parliament and to the firms they regulate by National Audit Office audit are appropriate to the role of the FCA.

5. *Are the powers of the FCA suitable? Will their exercise be subject to appropriate scrutiny? How should the FCA be interacting with industry as well as using its intervention powers?*

15. In line with our wish to see proportionate, appropriate and cost-effective regulation we welcome proposals on a sector-specific approach to conduct regulation. A differentiated and risk based approach to the various financial sectors to be regulated by FCA is essential to achievement of proportionate, appropriate and cost-effective regulation.

16. We acknowledge and agree that the FCA should not take on the role of vetting and pre-approving products. For the efficiency of markets and to ensure responsibility in this respect remains firmly with firms' senior management, we see FCA's role as one of monitoring development of products and intervening only at the point at which it believes there is potential for customer detriment.

17. Becoming involved with individual products prior to their launch would risk FCA's resource being deflected from its primary regulatory and supervisory role. It might also present potential customers with the misleading picture of quasi FCA approval of a product. We also do not see this as a relevant tool in respect of insurance intermediaries and development of general insurance products in response to customer demand.

18. Please also see our comments above in answer to question 3 in respect of publishing warning notices.

19. In view of the pivotal role they play in encouraging consumers to purchase financial products or services, we agree with the proposal for the FCA to have power to direct firms to withdraw or amend mis-leading financial promotions.

6. *How will the break-up of the FSA work in practice? Issues of coordination and information sharing between the FCA and the Prudential Regulation Authority (PRA)*

20. We see the challenge the Government, Treasury and Bank face in this respect is ensuring that the FCA, its staff, regulated firms and the general public do not perceive the FCA as the "junior member" in these new arrangements.

21. Failure in this respect could undermine the effectiveness of the FCA, affect the quality of staff FCA may attract and risk the loss of confidence of both regulated firms and the general public. We believe this to be a potential risk and one which needs to be addressed during implementation of the new arrangements.

22. For a firm such as ourselves, which will be regulated by only the FCA and replacing regulation by FSA, we do not expect to experience any significant disruption to our relationship with the regulator. We do acknowledge that for those firms moving from a single regulator to two then the potential for disruption will be greater.

23. Although firms regulated solely by FCA may not appear to have an interest in a successful coordination process we are mindful of the potential for such process to create precedent with wider application and therefore, see the close and regular communication between PRA and FCA as essential. The risk of "copy across" rules, eminently sensible in the context of firms regulated by the PRA but not perhaps appropriate to the prudential regulation of firms solely regulated by the FCA. Coordination will be necessary but tempered by effecting rules specifically appropriate to the type of firms and their activities, regulated by the FCA.

7. *How should the FCA be interacting with other domestic regulators? For example, the FCA's relationship with the Bank of England and Financial Ombudsman Service*

24. Much of the work of the Financial Ombudsman Service (FOS) arises from sale and product issues that will be directly related to FCA's conduct of business rules. It is therefore appropriate that there should be a close working relationship in respect of the manner in which those rules operate and their outcomes. However, there also needs to be a clear line of independence maintained by FOS in relation to decision making in order to retain the confidence of consumers and regulated firms.

8. *How should the FCA be interacting with international regulators? Do EU regulation initiatives restrict or enhance the work of the FCA? Will the FCA be able effectively to engage with the EU supervisory authorities?*

25. We are concerned that with major work occurring in the EC on IMD2 during this year and next, the UK's seat on the European Insurance and Occupational Pensions Authority (EIOPA) will be held by the PRA, presumably the part of FSA operating as a "shadow" in that respect. As much of the work on IMD2 will be in respect of conduct of business issues we would wish the part of FSA creating a "shadow" of FCA to be actively involved in carry out this responsibility and engaged in avoiding any detriment to the UK financial services industry in the implementation of IMD2.

9. *General comments—whether the FCA, as planned, will deliver its objectives and better than achieved by FSA?*

26. It is too early to draw any conclusions as to how effective FCA will be and whether that will be an improvement on the work of the FSA. There have so far been a number of Government papers outlining the shape of a new regime, including a revised FSMA 2000 Act and an FSA paper on how it believes the FCA's objectives may be delivered. However, in spite of the weight of those documents the detail of how FCA will be different in practice and the detail of what changes regulated firms will have to manage is as yet too thin to make any sensible judgement. As the early development of a revised IMD is also being managed in tandem by the EC it is also unclear what effect that may have on the final shape of the regime.

October 2011

Written evidence submitted by London and International Insurance Brokers Association

LIIBA is the Trade Association representing Lloyd's Insurance Brokers. They introduce virtually all of Lloyd's business and a significant proportion of London companies business, as well as placing considerable volumes in International Markets. They handle in excess of £80 billion of insurance premiums and claims annually. Some of our members also handle significant amounts of small/medium sized commercial, as well as, personal insurances.

We have already made a response to the FCA on its paper entitled "Approach to Regulation". We would however, like to make the following comments in response to the Financial Conduct Authority Enquiry.

The FCA's single strategic objective is very broad and could encompass almost anything. In reality the actions of other bodies eg Bank of England, are likely to have a greater impact on "protecting and enhancing confidence in the UK financial system". The operational objectives are a more realistic description of the role of the FCA. However, it is essential that the regime recognises the difference between retail (private) and wholesale (commercial) customers and adopt a differentiated approach to regulation.

We have no comment to make with regard to whether the FCA should have a primary duty to promote competition within the banking sector and all our comments relate to the FCA in terms of the insurance sector only.

We believe that there is a tendency to link all regulated entities under the same "umbrella". The concept of "one size fits all" is inappropriate. By way of example, throughout the financial crisis the London Insurance Market continued to make a significant contribution to facilitating international trade and commerce. In 2009 the insurance sector contributed £9 billion in invisible exports with Lloyd's Brokers accounting for £1.9 billion. It is not only quite wrong, but potentially damaging to our Market, to tarnish all sectors of financial services as if there were all directly responsible for the financial crisis and/or mis-selling in the retail sector. It is vital to differentiate the messages, criticising those sectors that have failed to perform but also publicly recognising those that continue to make a positive contribution. It is also vital to recognise this difference as regulatory policy and the approach to supervision are developed.

We fully support the continuance of improved enforcement capability and principles-based, risk-based regulatory policy, rules and supervision, such that the principles do not become a means of unfair and unpredictable enforcements/disciplinary practice.

We believe that the FCA must adopt full and open consultation on its rule book.

The Regulator must properly observe the differences between wholesale and retail business. To this end we believe it is of fundamental importance that the composition of the FCA Board, the Rule Book, and the FCA's approach to supervision adequately reflects the different issues facing the wholesale sector. A one size fits all approach is not appropriate.

We believe that it is essential that there should be greater "regulation of the Regulator" to ensure that fairness is achieved in dealing with the regulated. An independent appeals panel should be set up with the power to direct the Regulator if its actions prove to be disproportionate or incorrect—with the obligation by the FCA to compensate the regulated firm if complaints are upheld. This is particularly true of Section 166 notices where there is no accountability for such requests nor compensation of costs. Equally it would appear to be misguided to fine an entity purely on the grounds that, in the view of the regulator, inadequate systems and controls were not in place, unless prior clear written notice about what should in place had previously been given. Fines should be based on actual failures or wrong doing. The number and amounts of fines levied against regulated firms should surely be seen as a failure not as a success.

We are very concerned about the proposal to disclose investigations before any wrongdoing is established. The impact on the share price of eg Gartmore and CPP demonstrate the dangers.

We believe that excessive intervention in the right of commercial self-determination of firms, for example in staff questioning business models, business strategies etc. should be resisted.

An over-riding consideration is the importance of having an effective and proper management team at the FCA. There have already been a great number of changes in regulatory and supervisory management of our sector in recent months. It is vital to the success of the new regulator that there are appointments at senior level of those who understand the wholesale Market and its relevance to the UK economy.

We have serious concerns that the "twin peaks" approach will weaken the UK's voice in the European Supervisory Authorities. EIOPA remains responsible for insurance intermediaries but it is clear that the PRA will represent the UK. The new structure gives a great deal of influence to the ESA's in terms of levels 2 and 3, the delegated act approach and in developing technical standards. It is essential that the FCA is not regarded as a junior partner and adequate arrangements are made to ensure the FCA plays a full role in EIOPA's work on all issues affecting intermediaries.

It is hoped that you will find the above comments of assistance. We would be happy to develop them further if it would be helpful to do so.

October 2011

Written evidence submitted by the Building Societies Association

Introduction

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

Executive Summary of the Current BSA Position

2. We have two high-level points. First, it is very important that the new FCA builds upon the recent improvements in conduct of business regulation. While we recognise that the proposed regulators will, understandably, wish to make their mark as new organisations, it would be very unhelpful for consumers, businesses and the UK economy if, from early 2013, there was a regulatory "hiatus" while new regulatory approaches were floated. The FSA's recent supervisory enhancement programme; its strengthened consumer/collective redress powers; its move to a "shadow" FCA; and current regulatory changes, such as the mortgage market review and retail distribution review, should mean that the FCA can "hit the ground running".

3. Second, we think it important not to over-load the FCA with additional responsibilities. The key advantage of the twin-peaks regulatory model is that it should enable the regulators to focus more on their basic objective and not be looking in different directions. Therefore, we do not agree with other commentators who would like to see the FCA, for example, become a competition regulator (as opposed simply to having a role in promoting competition), or regulate claims-management companies (their regulation requires overhauling, but not re-locating). While we support, in principle, the proposal for the FCA to regulate consumer credit because this would be consistent with its other proposed responsibilities, we would have serious concerns if it had to be under a model that involved the relevant legislation being dismantled and transferred wholesale into the regulatory handbook.

4. The BSA welcomes a number of developments relevant to the FCA; most notably

- a series of helpful, high-level regulatory principles and objectives proposed in the White Paper and draft Bill, most notably efficiency, proportionality, consumer responsibility, transparency, promotion of competition, and co-ordination between the new regulators—it is important that the industry continues to work closely with the regulators and other relevant parties to help ensure that these principles are applied in practice;
- the re-naming of the new conduct authority and strong assurances by the Government that the FCA will act fairly and impartially;
- the acceptance by the Government of a continued "single gateway" for authorisations and certain other regulatory functions, which will be welcome at a practical level to dual-regulated firms—we would like to see as much co-ordination as is practicable between the FCA and the PRA; and
- a commitment by the Government to address the handling of "mass claims".

5. We believe that certain matters require further consideration and/or clarification before the FCA officially assumes its responsibilities in 2013; namely:

- careful planning to ensure that the new FCA's approach to conduct of business regulation is effective, fair and proportionate and, in particular, that smaller firms are not disproportionately affected by regulatory burdens; and
- in due course, clarification of how the proposed "product intervention" powers will work in practice.

6. The BSA has continuing concerns about:

- the costs of the migration to a twin peaks model, especially those related to regulatory IT systems—the most recent impact assessment revises the "best estimate" of total costs from £400 million to *£770 million* and we would appreciate much greater clarity about this matter and clear safeguards against excessive costs;
- the complexities of dismantling the Consumer Credit Act and porting it into the FSA/FCA Handbook—if the FCA is to assume responsibility, the BSA strongly believes that there should either be a "lift and shift" approach that minimises disruption for firms and consumers, or a genuine exercise in simplifying the consumer credit regulations and removing the copious "gold-plating"; and

— certain aspects of the proposals regarding pre-publication of warning notices.

The Treasury Committee's Questions

1. *Are the objectives of the Financial Conduct Authority (FCA) clear and appropriate?*

7. Yes, the BSA supports the FCA's proposed strategic and operational objectives. It is particularly important, in order to help avert a repetition of the previous problems with the FSA, that the new body has a single strategic objective, ie protecting and enhancing confidence in the UK financial system, underpinned by the specified operational objectives. It is not in the interests of consumers, business or the UK economy to have a situation where the financial services regulator is facing in different directions.

2. *Should the FCA have a primary duty to promote competition as recommended by the Treasury Select Committee and Independent Commission on Banking? How should this work in practice?*

8. We support, in principle, the Government's plan to merge competition functions within one body on the basis of a single Competition and Markets Authority to ensure the flexible allocation of scarce public resource to competition issues as they emerge, and for the combined body to be a stronger advocate for pro-competition policy across Government, including in the delivery of public services.

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

10. The FSA/FCA will be very busy in establishing a new regulator, while not only continuing with day-to-day regulatory work but also taking on new responsibilities (eg, as planned in due course, for consumer credit). It really does not need an additional role as a competition enforcement agency. Therefore, we support the conclusion in the White Paper (paragraph 2.115) that the FCA should have power to initiate an advanced referral to the competition authority, but should not become a competition regulator.

3. *Does the FCA's approach to regulation, as outlined in the Financial Services Authority (FSA)'s June 2011 document, represent an improvement on that of the FSA?*

11. The BSA has responded to the June 2011 document www.bsa.org.uk/docs/policy/regulatory_reform/bsa_response_fca.pdf. We believe that the approach outlined in the document, if implemented in a focused and proportionate manner, is capable of delivering improved conduct of business regulation.

12. The BSA supports the FSA's aim to *"intervene, earlier in the product chain if necessary, to anticipate consumer detriment and choke it off before it occurs"*. Appropriately focussed early intervention would benefit consumers and firms by reducing the risk of large scale product failures which damage the reputation of the financial service industry, harm consumer confidence and cost the industry large amounts in redress.

13. The right balance needs to be struck between the greater use of regulatory powers to prevent consumer harm and allowing firms the freedom to develop innovative products and services. Therefore, we welcome the recognition by the government that the power must be appropriately safeguarded.

14. There are a number of wider questions about product intervention; for example:

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

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

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

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

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

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

4. *To whom should the FCA be accountable? Are the lines of accountability clear?*

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

16. The FCA should have arrangements to assess, after an appropriate period of time, how successful regulatory initiatives have proved to be—especially if the FCA is to have greater product intervention powers.

For example, TCF (treating customers fairly) was—and continues to be—enforced quite rigorously, but there has been little detailed public feedback or analysis of its overall impact. This was somewhat surprising, given the duration, scale and importance of the TCF exercise.

17. We have certain specific qualifications, which persist following the publication of the White Paper, concerning the following:

— the description of the FCA as a "consumer champion", although we welcome the confirmation that the new body will act as an impartial regulator—the matter could be put beyond doubt if the legislation contained an explicit requirement for the regulator to act in a fair and impartial manner;

— the exercise of the new powers concerning financial promotions and early publication of disciplinary action (see below); and

— "regulation by speech" (see below).

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

18. Regarding the new powers envisaged for the FCA in relation to financial promotions, a firm would have only a short time to make representations before the FCA finalised and published the notice. Because appeal to the Upper Tribunal would be available to the firm after the notice had been published, it would be very important that the FCA used this power only in cases where the advertisement was misleading beyond reasonable doubt.

19. We have serious concerns about the proposed power for the regulators to be able to publish the fact that they are *proposing* to take enforcement action. Advance publication of *proposed* enforcement action risks a new presumption of "guilty until proven innocent" in respect of regulated firms, which is unlikely to improve confidence in the regulatory system. The planned safeguards are inadequate; the reputational damage having already been done. As we understand it, the FSA often begins investigations that lead to no disciplinary action.

20. Our concern is that, once information about proposed enforcement action is published, reputational damage will be done to the firm, irrespective of the outcome of the action and without the firm having had recourse to an appeal process. While we acknowledge that such publication is technically not the same thing as a final determination of rights, it can have a very similar effect in terms of a firm's reputation. Further, the firm will not have an opportunity to appeal to the Upper Tribunal or to the courts in the time available. We believe that the Government should give serious consideration to the unintended consequences of the proposed measure, to the principles of natural justice and to the fundamental rights of the firms involved.

21. While comment by regulatory officials often provides welcome illumination to the regulator's precise objectives in pursuing a particular course of action, and in answering firms' questions about regulatory activity, the problem of "*regulation* by speech" needs to be addressed. Currently, speeches by senior FSA staff, although explicitly not binding, may nevertheless be taken into account in enforcement actions. While regulated firms should of course read and digest relevant speeches by the regulator as far as practicable, speeches are not an appropriate medium for delivery of binding regulatory material or even formal guidance. We would like it to be explicit that FCA speeches will have no formal regulatory status, including in terms of enforcement.

5. *Are the powers of the FCA suitable? Will their exercise be subject to appropriate scrutiny? How should the FCA be interacting with industry as well as using its intervention powers?*

22. The BSA regards the proposed powers of the FCA and the scrutiny arrangements as broadly acceptable. However, the FCA's primary focus will be on preventing *wrongdoing* by regulated firms. The BSA supports this focus, but would like the FCA also to concentrate on helping firms *get things right.* The use of practical arrangements, like more informal pre-consultations with industry bodies and the establishment of industry panel working groups could be useful in this regard.

23. The BSA has regular meetings with relevant FSA/FCA "shadow" departments, including the conduct of business policy team, the conduct of business risk team, the redress policy team, the FSA handbook team etc. We find these meetings invaluable and look forward to a continued high degree of liaison and co-operation under the new FCA as it moves forward both in its "shadow" and its substantive forms. The BSA is very keen to act in a spirit of constructive engagement to help ensure fair and effective regulatory arrangements.

6. *How will the break-up of the FSA work in practice? Issues of coordination and information sharing between the FCA and the Prudential Regulation Authority (PRA)*

24. While fully accepting that each new regulator will need to conduct their activities using methods that they regard as effective, the move to "twin peaks" regulation risks the abandonment of mechanisms that already work well. There is also the risk of separate functions developing that cause unnecessary duplication, complexity or confusion, especially for dual-regulated firms (ie those regulated by the PRA *and* the FPC). We welcome the proposed statutory duty on the FCA and the PRA to co-ordinate, but believe that success will depend on how the regulators deal with their objective in practice, rather than on a high-level statutory requirement.

25. In practice, the risks inherent in a twin peaks system could be reduced by the retention of:

— a common gateway for dual-regulated firms in respect of authorisations, approvals, variations, waivers, notifications etc;

— the integrated regulated reporting system (GABRIEL); and

— a single regulatory handbook (or, if this not practicable, two handbooks that are properly coordinated and aligned and to help ease of access, especially for firms subject to the requirements in both handbooks, and to prevent overlap, underlap, terminological inconsistency etc).

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

26. We note the confirmation in the White Paper that *"Industry representatives were almost unanimous in their view that there should be some form of 'single point of contact' or 'shared services' for regulatory processes"* and are encouraged by the Government's decision to incorporate arrangements for a single gateway into the draft Bill.

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

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

7. *How should the FCA be interacting with other domestic regulators? For example, the FCA's relationship with the Bank of England and Financial Ombudsman Service*

29. See the reply to question 6 above. Regarding the Financial Ombudsman Service it is, of course, imperative that the FCA and the Service co-ordinate, especially in the area of "mass claims", but we agree with the statement in the Government's White Paper that the Financial Ombudsman Service should be allowed to concentrate on *individual* complaints, while "wider implications" (WI) principles and issues are dealt with by the relevant agencies (the FCA, the courts etc). However, there is still much work to be done to ensure that we have arrangements in place to deal with WI cases successfully, especially in view of the possibility that Ombudsman decisions will be made public.

8. *How should the FCA be interacting with international regulators? Do EU regulation initiatives restrict or enhance the work of the FCA? Will the FCA be able effectively to engage with the EU supervisory authorities?*

30. It is imperative that the UK regulators coordinate closely with the European authorities in order to represent the UK interest—UK regulators will no doubt understand the need to ensure that their divided roles must not be allowed to reduce the strength of UK representation in the EU regulatory framework. There should be a standing requirement for the Treasury, PRA or FCA as the case may be, to carry out both consultation and cost-benefit analysis on any proposal for European legislation in order to establish what negotiating position actually represents the UK national interest. Informal soundings are simply not robust enough.

31. It is also crucial to avert further episodes of legislative "front running" ie where UK agencies introduce new laws, rules or regulations, which then have to be unravelled because of the implementation of EU legislation that was already in the pipeline when the UK exercise began (consumer credit legislation is a clear example of this practice, which is very unhelpful to the UK economy). It would be most welcome if, in addition to its very helpful recent commitment against "gold-plating" of EU law, the Government could also commit to ending the damaging practice of "front-running" and that the FCA should also commit not to engage in this practice.

October 2011

Written evidence submitted by the Council of Mortgage Lenders

Introduction

1. The CML is the representative trade body for the first charge residential mortgage lending industry, which includes banks, building societies and specialist lenders. Our 109 members currently hold around 94% of the assets of the UK mortgage market. In addition to lending for home-ownership, the CML's members also lend to support the social housing and private rental markets.

2. The CML welcomes the opportunity to provide evidence to the Treasury Select Committee. The CML has submitted responses to all of the HM Treasury (HMT) consultations on the proposed regulatory structures in July 2010, February 2011 and July 2011, as well as the Financial Services Authority's (FSA) discussion paper DP 11/1 on product intervention and its approach document for the Financial Conduct Authority (FCA).

3. As with those responses, our views outlined below are based on discussions with members and our experiences with the FSA, in particular our engagement in the Mortgage Market Review (MMR) and in negotiations on specific issues, including Mortgage Payment Protection Insurance and Mortgage Exit Administration Fees. As such, we have only covered issues that are of most significance to our members' mortgage lending and administration activities.

Key Points

4. We recognise that the approach to regulation outlined in the document represents the FSA's aspiration for its successor, the FCA. Of all of these aspirations we believe that three are particularly important if the FCA is to be successful in achieving its statutory obligations.

5. Firstly, if the FCA is to intervene earlier in the process and be a judgement-led regulator it must be transparent in order to ensure that stakeholders understand its actions, even if they do not always agree with them. Secondly, and in order to achieve transparency, it must have open and frank dialogue with all stakeholders. Finally, given the breadth of the FCA's regulatory scope it must differentiate between markets, products and consumers. A one-size-fits-all approach to regulation must be avoided, as it will undoubtedly have negative consequences for consumers and firms alike.

Are the objectives of the Financial Conduct Authority (FCA) clear and appropriate?

6. We welcome the clarifications in the white paper and draft Bill and support the single statutory objective of the FCA. Equally, we broadly support the three operational objectives. We would, however, echo the comments in our response to the February consultation paper. The regulator should have an appropriate degree of protection for consumers and should reflect a differential approach not only between market and retail consumers, but within the retail market itself.

7. In developing the MMR, the FSA has stated that it is not seeking to create a one-size-fits-all approach to mortgage regulation, recognising the differing needs, circumstances and financial capability of consumers. We strongly support this approach and believe that the FCA should apply a differentiated approach between retail consumers wherever possible and should be specifically allowed to do this on the face of the Bill.

8. The enhanced approach to both the promotion of efficiency and choice and the requirement to discharge its functions in a way that promotes competition are positive changes as they will encourage a better understanding of the market dynamics that will be essential to inform the proactive approach to the FCA (including its new product intervention powers). We also think that it is appropriate that the FCA should be able to make referrals to the OFT, where it believes that there are structural competition issues that are causing consumer detriment.

9. In order to achieve this, the FCA will be required to look at product pricing to determine if there are any competition issues that it needs to address. But price regulation is not the government's intention for the FCA, nor should examination of product pricing be at the expense of considering other influential factors such as service, innovation and quality.

10. Therefore we strongly believe that the draft Bill should be amended to reflect the government's intention in order to provide clarity around the scope of any new price intervention powers that may be necessary. Once the powers are framed in the legislation, the FCA should provide a clear view to stakeholders when and how the powers could be employed.

11. The inclusion of the regulatory principles is welcomed; in particular the acknowledgement of consumers being ultimately responsible for their actions. This is an important legal acknowledgement of an essential feature of an efficient market—but one which is lacking from the current framework.

Should the FCA have a primary duty to promote competition as recommended by the Treasury Select Committee and Independent Commission on Banking? How should this work in practice?

12. As outlined in our response to question one above, we welcome the proposal for the FCA to have due regard to competition in the HMT's white paper and draft bill. We would support the escalation of this to become a primary duty. The benefits of doing so would be to ensure a diverse market, populated by a range

of different firms (banks, mutuals and non-banks) offering products that meet the needs of a broad range of consumers.

13. In practice, we suggest that the focus should be on competitiveness of the UK and within individual market sectors. There is a risk that a focus on competition could result in an overlap with the remit of the Office of Fair Trading and Competition Commission in becoming an arbiter of competition law and an economic—or price—regulator.

14. It is clear from the White Paper and Draft Bill that it is not government's intention that the FCA becomes an economic regulator and therefore any escalation in the status of its competition function must also clearly define its scope and remit.

Does the FCA's approach to regulation, as outlined in the Financial Services Authority (FSA)'s June 2011 document, represent an improvement on that of the FSA?

15. Paragraph 1.11 outlines the government's intention for the FCA as an organisation. Many of these points are discussed in greater depth later in the paper and in our responses to the HMT's consultation papers. An important point that is worth highlighting is the intention to *"set clear expectations for firms and be clear about what firms can expect from the FCA"*. As stated above, we agree that it is important for firms to know what the regulator expects of them.

16. The advice given by the FCA in any preliminary discussions should be able to be relied upon—by firms or by the FCA—in any future FCA investigation, FOS complaint handing or court processes. The fact that the firm followed FCA advice (or the fact that they didn't see the need for any advice) must be taken into account, though not decisive, in considering whether such action was fair and accorded with rules and principles at the time.

17. We think that it is equally important for firms to be clear of what they can expect from the FCA, in terms of day-to-day supervision, the new powers and the purpose and desired outcomes of any future changes to regulation. This is best achieved through clear statements from the regulator, but perhaps more effectively, through an ongoing cooperative dialogue (both formally and informally) with firms.

18. Without an understanding of what to expect from the FCA, the regulator risks disconnection amongst stakeholders where the reasons behind its judgement-led actions are either unknown or unclear. If firms clearly understand the motivations of the regulator and the reasons for it, it is more likely to achieve buy in from those firms. In the worst case scenario, if there is disagreement with the FCA's policy decision, the industry will at least be aware of the reasons why.

19. For these reasons, we believe that it is essential that, wherever possible, the FCA identifies clear goals with measurable outcomes for its regulatory interventions (particularly major interventions like the MMR). These should be reported via post-implementation reviews to determine if the regulatory goals have been achieved as well as identifying the actual costs (both to consumers and firms). This would also help inform future regulation and the formulation of cost-benefit analysis. The document makes this point in paragraph 5.5.

20. Therefore, as outlined in paragraph 1.15 of the document, we welcome and strongly support that engagement, transparency and co-operation are essential elements of the FCA's intended culture in order to command the respect of consumers and the firms it regulates. Equally, we agree that this can lead to improved outcomes for all parties, particularly consumers.

To whom should the FCA be accountable? Are the lines of accountability clear?

21. We strongly support proposals to enhance the FCA's accountability to government and parliament, and believe that there may be a case for looking at further ways to enhance accountability of the regulator.

22. The current proposals seek to ensure accountability via appointments to the FCA's board, reports to HMT on regulatory failures and for an independent review of the regulator's efficiency and effectiveness. Given that the FCA's actions can directly impact on broader government policies, for example restrictions on mortgage lending could have a dramatic impact on the government's housing policy, we believe that it is appropriate for the FCA to have to consider and publish its findings regarding the potential impacts of its actions on government policy. Alternatively, the government should be able to raise any concerns it may have with FCA's policy, whilst respecting its independence.

23. This accountability could be limited to rule changes, or other actions, that would have sectoral or market wide impact.

Are the powers of the FCA suitable? Will their exercise be subject to appropriate scrutiny? How should the FCA be interacting with industry as well as using its intervention powers?

24. Paragraph 4.3 of the document states that the FCA will be ready to intervene in markets or products where there is evidence that they are not operating in the interests of retail consumers or the wider economy. It is the first time that the protection of the wider economy is added to the reasons why the FCA may intervene in products. This may be a reference to the FCA's markets responsibility (although the draft Bill restricts the

use of product intervention into markets without consent from HMT), or could potentially cross into the Financial Policy Committee's (FPC) responsibilities. Alternatively, it may mean that the FPC can direct the FCA to use its product intervention powers, where it believes that a product is harmful to financial stability. We would welcome clarification on the rationale for this potential widening of scope.

25. We can see the benefits of addressing the "causes" of consumer detriment earlier to avoid crystallisation and large scale redress. In our response to the FSA's discussion paper on product intervention we outlined our concerns with this policy and how it would need to be exercised with caution. We therefore welcome the confirmation in the draft Bill that the FCA will be required to have a clear policy in place outlining the circumstances on when it can intervene in a product or sales process.

26. Controls are fundamental to provide greater certainty to firms of when the regulator may use these powers. Therefore, we believe that further controls are necessary, specifically where the power will be used to intervene on a market wide or sectoral basis. To justify such action, which is likely to have significant market impacts, there must be clear evidence of consumer detriment on a large scale, and the FCA must consult with the PRA and FPC to ensure that the action will not have a negative impact on the financial stability of firms or the system itself.

27. Without appropriate controls, it could stifle innovation in the market as firms take a risk-averse approach to product development to pre-empt and avoid intervention. Equally, where the FCA does have evidence of the need to intervene, it is beneficial to all parties (consumers, the regulator and firms) that there is a time limit of a year for action to be taken. This can ensure that solutions are not drawn out over lengthy periods.

28. In terms of interaction with firms, we believe that an improved dialogue is essential to the FCA achieving a number of its goals. We discuss this in more detail in response to question three above.

How will the break-up of the FSA work in practice? Issues of coordination and information sharing between the FCA and the Prudential Regulation Authority (PRA)

29. We support the transition to a twin-peaks model of regulation, but remain concerned about how the PRA and the FCA will work together in practice. We welcome some of the details outlined in chapter six of the white paper, but the risk that regulators take divergent approaches remains. As far as is possible, the regulators must seek to minimise such risks and avoid presenting firms with a dilemma in the event that divergent requirements conflict. 30. This is particularly pertinent given that prudential regulation measures can have a profound impact on conduct outcomes and vice versa. For example, in 2009 there were conflicting conduct and prudential issues connected to mortgages tracking the historically low Bank of England base rate. It is possible that similar concerns will arise from the FSA's guidance consultation on forbearance and impairment provisioning. This risk is exacerbated as both the PRA and the FCA will be proactive, judgement-led regulators that seek to intervene earlier in the process, to avoid detriment crystallising.

30. Furthermore, the indication in the HMT's white paper and draft Bill states that where firms are dual regulated, the PRA will be the lead regulator and can, in certain circumstances, veto actions of the FCA. This could have an impact on firms where they are faced with conflicting regulation from the two regulators.

31. The draft Bill creates a statutory duty for the FCA and PRA to cooperate, the details of which will be published in a memorandum of understanding (MoU). The MoU must be clear on how the regulators will resolve conflicting positions and regulation. We believe that, in the interests of transparency, where such conflicts are in the public domain the agreement between the PRA and FCA as to how this will be resolved should be published. It is vital that firms are given regulatory certainty to reduce risks of non-compliance and improve customer outcomes.

32. Practical issues remain regarding the ownership and format of the current FSA handbook, the approach to supervisory visits and other similar processes that could either be duplicated or shared. Wherever possible, we would encourage the new regulators to share core services and processes to minimise disruption to firms in the short term and ongoing costs over the longer term. We welcome a single gateway for approval of firms and a joint approach to the approved persons regime as good examples of this practice in the White Paper and Draft Bill.

How should the FCA be interacting with other domestic regulators? For example, the FCA's relationship with the Bank of England and Financial Ombudsman Service

33. We strongly agree that the Financial Ombudsman Service (FOS) should focus on processing individual complaints on a case-by-case and in doing so it should not seek to set legal precedent or change regulation. The same principles must apply to the formalisation of the wider implications referral process.

34. We agree that the FOS should be able to make referrals to the FCA where it has evidence of large scale detriment with common underlying issues relating to a specific product and/or sales process. The FCA should be required to consult on, and then publish, the circumstances when the FOS can make referrals. Within this control there should be a clear understanding of what constitutes "large scale detriment".

35. We would caution against the extension of the power to make referrals to the FCA to include consumer groups. The major concern we have is that such referrals are likely to be based on a partial or incomplete

picture of a subset of consumers that have made contact with a specific group. Such referrals, in a worst case scenario, could be reactionary in response to speculative media coverage. The role of the consumer panel within the FCA structure, has been, and should continue to be, adequate in highlighting consumer issues that are of concern. The experience of the OFT with supercomplaints will be relevant; and there should be a formal assessment of how that power has been exercised and the value which it has delivered before this power is granted.

36. Finally, given the increasingly significant role of complaints management companies (CMCs) in the market, there is a strong possibility that the move to early intervention more broadly, as well as FOS referrals to the FCA, could create a self-fulfilling process. The actions could trigger the CMCs to cultivate complaints, thereby creating escalating the exact issue that the FCA is trying to avoid.

How should the FCA be interacting with international regulators? Do EU regulation initiatives restrict or enhance the work of the FCA? Will the FCA be able effectively to engage with the EU supervisory authorities?

37. We believe that there will be significant challenges in maintaining a coherent, consistent UK voice in international discussions. Although we support the government's proposal to establish an MoU to help shape this, we believe that this should be further enshrined in the day-to-day operations of both regulators.

38. We would welcome assurances that both regulators will give due consideration to impending European or international developments "in the rear-view mirror", prior to consulting on and implementing UK regulation.

39. It is difficult to envisage under what circumstances both prudential and conduct regulation representation or engagement would not be required, considering the far-reaching consequences of international financial regulation reform.

40. For example, the draft mortgages directive (Credit Agreements Related to Residential Property) proposes a number of measures that are likely to be delegated to the European Banking Authority (EBA). These issues will be conduct of business related, and as the PRA will be the UK's representative on the EBA it could disadvantage us in detailed negotiations.

October 2011

Written evidence submitted by the Chartered Insurance Institute

EXECUTIVE SUMMARY

Overall view

1. The Chartered Insurance Institute (CII) welcomes the opportunity to submit evidence on the proposals to reform conduct of business regulation. We believe that the approach to regulation as set out in the FCA approach document, including the proposals to focus on firms' cultures and behaviours as a root cause of consumer detriment, is likely to deliver a far more effective regulatory regime. Our response therefore focuses on a number of specific suggestions to ensure that conduct regulation is made as effective as possible. In particular, we focus on what a good culture in retail financial services might look like and how this can be identified by supervisors.

Why a commitment to professionalism demonstrates sound culture

2. The central tenet of our argument, which is supported by previous FSA research, is that those *firms and practitioners* demonstrating professional behaviour through a verified commitment to qualifications, continuing learning and a code of ethics are *less likely to provide inappropriate advice to consumers*. We believe that improved professional conduct fits well with the ambition of the FCA to prevent rather than "clear up" detriment.

Why FCA supervisors should take note of "Chartered"

3. In the past, the term Chartered has been awarded to individual practitioners within the insurance and financial advice sectors that commit to the highest standards of professionalism. Now however, a number of firms have also been awarded Chartered status by demonstrating a continuing commitment right across the organisation to higher professional standards in the public interest. These firms must meet stringent criteria in order to be awarded the title and must continue to maintain high standards. Chartered firms are therefore making measurable commitments to *"embedding and maintaining a firm-wide culture that supports an appropriate degree of protection for customers"*.

Why supervisors should take note of the Aldermanbury Declaration (AD)

4. Firms that have signed up to the industry-led Aldermanbury Declaration (a voluntary commitment in general insurance to raise professional standards) have also made a long-term commitment to professionalism suggesting that their management are determined to embed a firm-wide culture that improves outcomes for

consumers. The fact they have made such a commitment should be noted by supervisors as part of their assessment of firms' cultures and behaviours.

About the CII

5. The Chartered Insurance Institute is the world's leading professional body for insurance and financial services with over 100,000 members in more than 150 countries. We are committed to protecting the public interest by maintaining the highest standards of professional and technical competence as well as ethical conduct. We are a not-for-profit organisation governed by a Royal Charter, which sets out our public interest remit "to secure and justify the confidence of the public and employers" in the profession.[28]

6. We promote the highest standards of professionalism for the financial services community and we do this in part by setting exams and awarding qualifications to financial services practitioners at the Certificate, Diploma and Chartered levels. We also require our qualified members to sign up to a Code of Ethics and undertake annual continuing professional development, both of which we enforce through disciplinary measures.

The Suitability of the FCA's Powers

7. The CII welcomes the FCA's proposed stance to "*place particular focus on firms' culture as a potential root cause of poor outcomes*".[29] It must be the case that when assessing the probability of consumer detriment, the regulator takes account of the behaviours and cultures of firms and their employees, as much as the more traditional structural and market wide factors. Only then will the regulator be able to attain a *"deeper understanding" of the "commercial and behavioural drivers and the multiple causes of poor outcomes for consumers"*. The challenge now then, is to develop a clear framework for how the FCA can identify appropriate/inappropriate cultures and behaviours.

Poor cultures, miss-selling and their implications

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

Consumer detriment caused by miss-selling scandals

9. Consumer detriment related to the selling of pensions and endowments in the 1990s and payment protection insurance over the last decade have one thing in common—intermediaries failed to act ethically during the distribution process resulting in the selling of financial products that were unsuitable for the end consumer. To act ethically it is not merely sufficient to have good intentions in terms of putting the consumer first. Those advising customers must also be competent enough to understand the risks associated with various financial products and their own limitations in advising on such products.[30] It follows that mis-selling is often both a function of deliberately selling an unsuitable product for financial gain and/or poor levels of competence and understanding about the risks of financial products and the related risk appetite of customers. The FSA identified both issues as key causes of consumer detriment as part of the Retail Distribution Review.

Decreased trust in financial services

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

11. *Trust* of financial services in general is relatively low. The decline in levels of trust was well documented in a survey undertaken by the CII in late 2010 which found that one in five respondents will never trust financial services again and 72% of people have not very much trust or no trust at all in financial advisers and life insurance providers.[31]

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

13. *"A pervasive sense of distrust among consumers means they are likely to write financial service providers off as 'all the same', without even checking what is on offer on the market. Furthermore, behavioural economics suggests that consumers become disengaged in the face of market complexity: they are therefore less likely to check the market if they cannot easily understand or compare products on it."*[32]

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

[29] FSA (June 2011), *Financial Conduct Authority: Approach to Regulation* http://www.fsa.gov.uk/pubs/events/fca_approach.pdf

[30] K Redhead, "*Behavioral Perspectives on Client Mistrust of Financial Services*," *Journal of Financial Service Professionals* (Working paper)

[31] CII (February 2010) *What we talk about when we talk about trust,* p.12 http://www.cii.co.uk/downloaddata/Trust_CII_2010.pdf

[32] Social Market Foundation (July 2011) *A Confidence Crisis? Restoring Trust in Financial Services* edited by John Springford, p.13

14. Inertia has therefore helped contribute to the significant savings and protection gap that was quantified in the Treasury's Simple Products Consultation Paper earlier this year. It is estimated that around *a quarter of UK households have no savings at all* and that the protection gap—the difference between "the amount of cover people hold and the level they should ideally have in place to cover their protection needs" is close to *£2.5 billion.*[33]

Delivering an appropriate culture through professionalism

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

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

16. Each of these "pillars of professionalism",[34] are directly associated with the likelihood of consumer detriment. If practitioners adhere to the highest standards of qualifications, CPD and ethics, it is less likely that they will either deliberately mis-sell for personal financial gain at the expense of the consumer, or accidently mis-sell a product due to a lack of understanding about product risk. Distributors will want to deliver a service that matches the customer's risk appetite and they will have the skills to do it. They are therefore more likely to sell products that are appropriately tailored to the individual.

17. The FSA and the Treasury have acknowledged the importance of each of these characteristics of professionalism for improving consumer outcomes as part of the Retail Distribution Review (RDR) which is aimed at raising the standards of retail investment advice. FSA research, referred to by the current Financial Secretary to the Treasury in November 2010,[35] found that advice from practitioners meeting the highest professional standards was deemed suitable in *71%* of cases whereas advisers with the current mandatory qualification delivered suitable advice in just *11% of cases*.[36]

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

— *Corporate experience and expertise:* management that has the necessary experience and expertise to ensure that the business model is sustainable implemented effectively;

— *Corporate systems and controls:* including corporate governance that exerts appropriate levels of control over the running of the business including risk management, maintaining adequate capital, record keeping, training and competency programmes and developing a culture that encourages the fair treatment of customers; and

— *Employee professional support:* encouragement of professional standards for employees through supporting technical training and development and encouraging appropriate behaviour.[37]

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

Evidencing professionalism through verifiable standards

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

[33] HM Treasury (December 2010) *Simple Financial Product Consultation Paper*, p.9 http://www.hm-treasury.gov.uk/d/simple_financial_products_consultation.pdf

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

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

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

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

Chartered firms

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

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

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

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

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

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

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

Aldermanbury Declaration

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

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

28. By the first anniversary of the Declaration, 200 firms including all major insurers had signed up to this commitment. We believe these proposals are ambitious but realistic and have called on all firms signing up to implement the changes by December 2013.

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

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

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

Professionalism and consumer trust

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

33. In 2009, on behalf of the CII, YouGov surveyed over 2,000 members of the public in an effort to understand consumer views about Chartered firms and individuals. This in-depth survey found that an important factor in determining whether or not people trusted a financial services firm or practitioner was whether they held the title "Chartered".[38] The headline results were:

- Consumers expect greater professionalism from Chartered persons and organisations.
- Consumers have greater trust in advice from Chartered professionals than professionals that are not Chartered.
- Consumers believe that you can generally trust the advice you get from Chartered organisations.
- Consumers have more confidence in the quality of organisations that use the term Chartered than those that are not Chartered.

34. There has also been research published on the links between professional body membership and consumer trust. A recent survey conducted by JP Morgan on financial advice found that a key driver determining whether a consumer is willing to pay for advice is membership of a professional body.[39]

Figure 1

DRIVERS THAT MAKE CONSUMERS WILLING TO PAY FOR AN ADVISER

Source: J.P. Morgan Asset Management

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

36. "Professional bodies play an important role as a proxy that enables consumers to place their trust in a professional. Knowing that a professional is regulated, meets certain standards of knowledge and is subject to a code of ethics facilitates trust even when the individual professional themselves is not known."[40]

37. The above research is noteworthy, particularly in light of the Government's priority to close the savings and protection gap.[41] High levels of professionalism epitomised by the title Chartered and membership of a professional body, appear to act as a break against the current wave of mistrust felt by the general public

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

[39] J.P. Asset Managment (May 2011) *Adviser charging: putting a price no financial advice* http://www.jpmorganassetmanagement.co.uk/Adviser/_documents/JPMAM_Adviser_Charging_Report.pdf

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

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

towards financial services. It follows that an increase in the number of Chartered firms and practitioners may, over time, lead to an improvement in the levels of trust and engagement with financial products and services. By ensuring that supervisors take account of developments like "Chartered" and the Aldermanbury Declaration in their risk assessments of firms, the regulator can provide an incentive for other firms to adopt best practice helping to improve standards across the industry.

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

38. The CII recognises the need to reform conduct of business regulation given the occurrence of significant consumer detriment under the FSA. Part of rebuilding confidence in financial services relies upon consumers being able to trust financial services regulation. However, as implied during Hector Sants speech at the FCA conference,[42] the regulator's new powers for intervention could, if left unchecked, significantly increase costs for consumers whilst reducing innovation and choice.

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

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

The FCA's Competition Remit

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

42. In certain financial services sectors, such as motor insurance, there are already a significant number of firms selling numerous products to compete fiercely for market share. However, this does not guarantee customers get value for money or protection from mis-selling. In our view, the key to securing the public interest is to ensure that consumers are able to understand what products best match their needs and risk appetites, and this requires *clear and transparent products* as well as *appropriate advice* from practitioners. Whilst this is related to the notion of "perfect competition",[43] the market for financial services suffers more than most from asymmetries of information, complexity, behavioural biases and lengthy terms, presenting significant challenges to a properly functioning demand side. This means that sometimes regulatory interventions must go beyond purely enhancing competition in order to protect consumers, particularly if targeted interventions will prevent the sorts of bulk mis-selling which has blighted parts of financial services in the past.

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

Interaction with the Financial Ombudsman Service

44. The FCA should make explicit use of other sources of information in order to proactively identify possible causes of consumer detriment. In this regard we support the idea that the Financial Ombudsman Service can refer specific issues to the FCA as a "nominated party". In her evidence to the Treasury Select Committee, Chief Ombudsman Natalie Ceeney highlighted how FOS complaints often arose as a result of "systemic issues" and how it was important to streamline the referral process to reduce detriment.[44] A key test then of this relatively "green" proposal is whether it is likely to improve transparency and communication between the Ombudsman and the regulator, shortening the time it takes to act once an issue has been identified. It is important though, that in referring issues and resolving cases, the FOS remains completely independent of the regulator. The CII will be interested to see how proposals on this front develop.

Domestic and International Coordination

General Coordination

45. The new regulatory architecture will be more operationally complex than the UK's current regulatory regime. It is therefore likely to face greater challenges in terms of coordinating its response to specific

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

[43] Perfect competition assumes prices and quality of products are known by all consumers. In this context, greater transparency of products should lead to improved consumer knowledge.

[44] Natalie Ceeney's oral evidence to the Treasury Select Committee Inquiry (14 October 2010)

regulatory issues, its day to day supervision and its policy making. In this respect we welcome the proposed statutory duty on the PRA and FCA to coordinate their activities, the obligation to prepare a memorandum of understanding and the commitment to having cross membership of boards.

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

International Coordination

47. As the current Eurozone crisis demonstrates, the UK's prosperity is intrinsically linked to the fate of other nations. If Spain was to default on its debt repayments, UK banks would face estimated write-downs of up to £75 billion[45] making further Government-led recapitalisations necessary. This example illustrates the importance of strong UK represention at the international level.

48. To ensure a consistent strategic view, the draft Financial Services Bill proposes an MoU between the various regulatory bodies. We believe that this may not be sufficient to ensure that the UK speaks with a single authoritative voice in international debate. We would therefore reiterate the CBI's call for the establishment of "an executive level international coordination committee, directly accountable to boards of regulatory bodies. The Committee would be comprised of representatives of the PRA and FCA and would oversee and be responsible for the regulators' international engagement".[46]

Conclusion

49. The CII supports the approach being taken to reform conduct of business regulation. In a financial world of substantial information asymmetries, it is vital that consumers are protected by robust regulation and supervision. Within this world, the *behaviours and practices* of practitioners are vital. In many cases, financial products may be sound in principle but because they are sold to people (either deliberately or accidentally) who do not have the appropriate risk appetite or financial need, they can ultimately cause widespread public harm. It is therefore crucial that when making assessments about the cultures of firms, the FCA recognises when organisations have demonstrated a commitment, or lack of it, to professionalism. There are a growing number of firms whose strategy is founded on providing the best quality products and services to consumers and in the process strengthening trust and confidence in the profession. It will be the FCA's job, in a new era of "differentiated", risk-based regulation, to distinguish between the risks posed by these firms and those that do not make such commitments to best practice.

October 2011

Written evidence submitted by Chris Howell

1. While the objectives of the FCA are clear, they could be considered less than appropriate—The FSA has switched from what could be considered as "close supervision" to a "light touch supervision" and currently back to "rather more intrusive supervision". While some providers and some major intermediaries (banks, direct providers etc) may require more attention, individual IFAs seem to attract far less criticism than the bigger organisations and therefore there is a question of whether they require "more intensive regulation". From the viewpoint of an individual IFA I see little evidence that the FSA has "prevented" much in the way of abuse of the system.

2. It is not unreasonable to recommend that the FCA should promote fair competition within financial services. However, there is a danger of trying to compare chalk and cheese. Competition within the banking area for traditional banking services is something that I would encourage. However, the wider issue of the overall services that are offered by banks and other major organisations calls into question the ability of these large organisations to provide a "personal" services to the consumer. Therefore I believe extreme caution should be exercised when looking at competition as there is a serious danger of the balance being tilted to the large organisation where service, inevitably, becomes less personal.

3. Personally I do not believe that the FCA approach to regulation provides any improvement against the regulation exercised by the FSA, or its predecessors. As far as I can see a criminal is not very likely to "volunteer" potential criminal activity when applying for authorisation. Therefore the FCA will be as reliant on whistle-blowing as has been the FSA. My view on regulation is still very much on the basis of "caveat emptor" and on that basis the onus of evidence of any wrongdoing should rest with the consumer rather than "assuming guilt" until the intermediary can prove innocence.

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[45] Jill Treanor (April 2010), *Debt crisis: UK banks sitting on £100bn exposure to Greece, Spain and Portugal,* Guardian http://www.guardian.co.uk/business/2010/apr/28/debt-turmoil-bank-crisis-fears

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

4. The FCA should be accountable to the Treasury Committee, Parliament and the Financial Services Industry. At the moment while the consumer is protected, the industry is not and is left to protect itself with what appears to be assumed guilt.

5. The powers conferred on the FCA seem a little heavy. But they could be deemed lighter with appropriate scrutiny, if necessary, from the Treasury Committee. The FCA should, most definitely, be interacting with the financial services industry as it should, in some way represent the industry.

6. If the FCA is working under the regulation and control of the PRA, it should have its records and terms fully open to inspection by the parent. However, I would suggest that this is carried out by someone with industry knowledge.

7. The FCA would need to be working very closely with Bank of England, FOS and any other regulator involved with the financial services industry.

8. FCA should, I assume, be able to work within the guidelines of EU legislation if we are to be subject to EU regulation throughout the future.

In Summary

9. I see this as a unique opportunity to get financial services regulation right from the viewpoint of both the consumer and the industry practitioner. As it stands in the event of a complaint it seems that the practitioner has to prove that the consumer was not disadvantaged in any way. If there is a suggestion that the consumer was disadvantaged, then the practitioner pays.

10. While that is not incorrect as an approach it does leave the practitioner open to complaint where the complainant has a memory of something different to the evidence on file. However, if the principle of caveat emptor applied, then it does give the consumer some responsibility for his/her financial decisions.

11. My submission has always been "if there is a complaint, can the adviser show that at the time of the sale, the recommendation was within the client's budget, was appropriate for the client's need, answered the client's specific requirement and was appropriate to the client circumstances at the time"? If so, then there is no complaint to answer, if not it was the wrong contract and the adviser was responsible.

12. In that event FIMBRA, LAUTRO. The PIA and the FSA could have been seen to "assist" the practitioner in ensuring that their records were appropriate to the contract sold and protected the practitioner from spurious or inappropriate complaints.

13. Unfortunately the present system does encourage consumers to listen to the "ambulance chasing complaint handling firms". I do not for one minute wish to criticise the justifiable complaint but I believe that there are some complaints which are totally unjustified and it is these that do not help the reputation of the financial services industry.

14. If there was a deposit required with every "lodged" complaint, £50 which would be refundable if the complaint was justified but which would be lost if the complaint was not justified and if the complainant could be responsible for the costs of the case if the complaint was thrown out, then I believe it would reduce the incidence of complaint to a somewhat smaller number than is currently the case.

October 2011

Written evidence submitted by Andrew Dickson FCII CFP, Chartered Financial Planner, Andrew Dickson Limited, Independent Financial Advisers

The FSA billed this as—"A series of regional events to discuss our early thinking on how the FCA will approach the challenge of meeting its proposed objectives".

I attended the event at Cambridge which was poorly prepared, badly managed and a complete waste of time. The representatives of the FSA clearly had no intention of digging into important issues raised, in many cases superficially, in its "Approach to Regulation" paper.

I will be prepared to give full details of this debacle if required but prefer to concentrate on key issues of the FCA's establishment.

1. Past History

Rather than re-cycling the mantras concerning confidence in the financial services sector and mis-selling scandals, it is worth basing opinion on actual experience rather than popular opinion lead by an ill informed media.

The notorious pension mis-selling inquiry was actually *closed off* by the regulator in 1994!

The Endowment mis-selling originated back in the 1980s. Contrary to basic principals of English Law, the regulator saw fit to prescribe "compensation" to policy holders whose policies still had years to run until they actually matured.

This resulted in a significant number of cases thatended with the policy actually reaching the original target value AND the policyholder keeping the "compensation" paid out, in addition!

A profound lack of understanding of the business by the regulator was the only possible explanation.

In more recent times, under the FSA's regime, Payment Protection Insurance has been aggressively sold by banks. The number of policies arranged by Independent Financial Advisers is known to be minimal.

The point here is *the broad-brush criticism of the financial services industry without identifying the particular sector causing the detriment is harmful to the large majority of businesses that, nevertheless, have the full confidence of their clients.*

2. The Need to Segment the "Advice Industry"

The FSA have failed miserably to tackle the bad areas of the market.

They have ignored calls to segment what they call the "advice industry" and identify the specific sources of the actual consumer detriment.

The FCA in future would be more effective in limiting the cost of regulation and the improving the results of its work if the different elements of the market are clearly identified and regulated proportionately.

An example is the contentious definition of "independent" advice.

To experienced professionals in the market, independence means free of any outside influence that could be detrimental to the consumer.

The FSA seems to have let the genie out of the bottle by allowing, in its ignorance, the insurance companies, banks et al to own and control "independent financial adviser" firms.

It is surprising, in our opinion, that the accountancy and law professional bodies accept this. Then, on the other hand, perhaps they have no choice because the FSA has decreed it.

Let us be quite clear: *a firm that is independent is representing the client/consumer.* There should be a clear statement of this relationship in the Client Agreement.

Not long ago the *Law Society* went to considerable lengths to clarify the law of agency with regard to general insurance intermediation but scant, if any, reference has been made to this at any stage of the FSA's life. It does, however, have an important bearing on the way that regulation is effectively used.

In segmenting the market to help isolate the persistent wrong-doers, this will be a strong dividing line between bona-fide *advisers*, and sales representatives of Banks and Insurance Companies.

The FSA has continuously ignored this division and favoured a "blurred" collective term "advice industry" perpetuating the confusion on the part of the consumer who thinks he is being *"advised"* when he is actually being *sold* whatever it happens to be.

The FCA will never command respect of either the consumer or the firms it regulates until it is able to fully understand and regulate appropriately the different elements of the "advice industry".

Unfortunately the "Approach…" document claims (3.11) that the FCA will do more to *explain what the consumer can expect from a regulated firm.*

Different parts of the "advice industry" have different objectives and obligations.

There is no way in which the FCA will be able to *explain what the consumer can expect* unless the different roles are clearly identified first.

3. Accountability of the FCA

Proposals in the "Approach…" document (4.17 onwards) are not acceptable when the draft legislation is read carefully. (*Finance Bill 2011—para 1F onwards*)

Composition of the Practitioners Panels, in particular, and the related definition of "eligible" persons, are wholly at the discretion of the new FCA, except for approval of the chairs.

Reviews of the FCA: it is specifically stated in the draft that Reviews are *"not to be concerned with the merits of the FCA's general policy or principles".*

The most important aspects, therefore, are appearing to be outside the range of the new "accountability".

This can not be acceptable given the ridiculous arrogance of FSA representatives in recent times, concerning their current lack of accountability.

The duty to consult (1H) *is limited* "…to the extent to which its (FCA's) *general policies and practices are consistent with its general duties* …".

This appears to leave a great deal of latitude for interpretation and avoidance of "consultation".

In 1M(2) there is no obligation on the new FCA to report or publish its responses to representations made by the Panels in a timely and comprehensive way.

This is unacceptable if we are to expect a responsible and accountable form of regulation in future.

4. Stop the Constant Change in Regulatory Requirements and Practice

Regulators over the years have had ample time to "learn from past experience" and it is high time they employed people with proper qualifications and knowledge of the markets they regulate.

This will hopefully avoid a continuation of changes to regulations and the constant barrage of Discussion Papers, Consultation Papers and Policy Statements that weigh heavily on the financial services sector to the extent that firms are seriously looking at moving out of the UK to a more realistic regulatory regimes in Continental Europe, for example.

October 2011

Written evidence submitted by Withers LLP

1. This is the response of Withers LPP to the following points raised by the Treasury Select Committee's inquiry into the Financial Conduct Authority ("FCA"):

— Does the FCA's approach to regulation, as outlined in the Financial Services Authority ("FSA")'s June 2011 document, represent an improvement on that of the FSA?

— To whom should the FCA be accountable? Are the lines of accountability clear?

— Are the powers of the FCA suitable? Will their exercise be subject to appropriate scrutiny? How should the FCA be interacting with industry as well as using its intervention powers?

Executive Summary

2. As the authors of *Leviathan at Large* predicted in 2000, the FSA has been one of the most powerful and one of the least accountable institutions created in the United Kingdom since the War.

3. Some of the 29 proposals for improvement put forward by the authors of *Leviathan at Large* remain current and should be enacted now.

4. The concerns identified and evidenced by the Centre for Policy Studies' *"Leviathan is still at large"* March 2005 report remain current. Indeed they have been intensified by the FSA's response to the financial crisis of 2007–09 with its move towards more intrusive and judgemental regulation coupled with an enforcement led approach.

5. The FCA's proposed approach to regulation is likely to continue that trend.

6. The current legislative processes to amend the Financial Services and Markets Act are likely to make the FCA less accountable and more powerful to the detriment of the regulated community and consumers.

7. The FCA should be held to the same standards of openness and transparency as the firms and individuals it regulates.

Leviathan at Large Proposals for Improvement that Remain Current

8. The following of the 29 proposals remain current and should be enacted:

8.1 Non-executive directors to have a more active role (proposal 6);

8.2 Removal of immunity against damages actions (proposal 7);

8.3 Statutory scheme for independent complaints investigator (proposal 11);

8.4 Complaints to go direct to investigator (proposal 12);

8.5 Complaints investigator to be able to award ex gratia compensation payments (proposal 13);

8.6 Independent investigator to make recommendations to the FSA on remedying well-founded complaints (proposal 14);

8.7 Widening the scope for judicial review (proposal 16);

8.8 FSA to act in a way which is fair, reasonable and proportionate (proposal 17);

8.9 Obligation on Authority to provide guidance on request (proposal 18);

8.10 Reform of costs mechanism (proposal 23);

8.11 Greater procedural safeguards for disciplinary offences (proposal 24);

8.12 Legal aid for those under investigation (proposal 25).

9. We do not propose to comment specifically on why each proposal remains current as to do so would in part merely repeat what was said in *Leviathan at Large* and because some of the proposals are interconnected with each other. Instead we will explain our various concerns further under the following headings:

Removal of the Statutory Immunity Against Damages Actions

10. The FSA enjoys immunity from liability from damages subject to only two narrow exemptions:

10.1 acting in bad faith; or

10.2 breach of section 6(1) Human Rights Act 1998 (breach of a right under the European Convention of Human Rights).

11. Neither exemption has yet been exercised. Case law suggests they will not be permitted to be exercised unless the exemption is removed or revised.

12. The need for this reform is underlined by the problems that have been created by the FSA taking what it has described as “pro-active and decisive” action. If the regulator is to be more intrusive and judgemental in its approach then it must also be properly accountable for its acts. Justice ought to be done when firms and/or individuals are caused loss because of something done or omitted by the regulator recklessly or by gross negligence, in the same way that individuals can recover when other public authorities or bodies act negligently (such as the police).

13. Other enforcement authorities, such as the police, do not have statutory immunity for damages. Unlike them, the FSA is unaccountable. Its officers and management know that no matter how recklessly or negligently they act or fail to act, they personally and their organisation are effectively immune from liability. The only censure they risk is criticism from parliament or stern words from the courts in a judicial review application. Even that criticism, while embarrassing for the regulator is rare because the Minister responsible for the FSA has admitted that there is a “democratic deficit”[47] and very few individuals or businesses can afford to challenge the regulator in the courts. If they do, their prospects of success are minimal with the current legal safeguards the FSA enjoys.

14. By sharp contrast, an individual who is accused by the regulator of not being a fit and proper person for example, is likely to immediately lose his or her job as his regulated firm will be under pressure to take action against him.

15. Legal aid is not available for referrals to the Upper Tribunal or to the courts in respect of financial regulatory matters. The individual therefore is faced with the prospect of paying legal fees in order to clear his name so that he can return to employment. However, even if he is successful and the Upper Tribunal declares that he is a fit and proper person, he cannot recover any of his costs from the regulator. This firm is aware of at least one occasion where an individual in exactly that position who was ultimately successful at the Upper Tribunal was forced to sell his house in order to pay his legal fees. And, even when successful, an individual has a strong stigma against his name in seeking employment from a regulated firm and approval from the FSA. Such a victory therefore could be pyrrhic in financial terms.

16. Even when the FSA is criticised, it tends to issue press statements which ignore the criticism or seek to downplay that criticism. For example, when Upper Tribunal recently overturned the FSA’s decision on the level of penalty suitable for Mr Jason Geddis and directed that, instead of the £100,000 fine and prohibition that the FSA were seeking the only appropriate penalty was a public censure the FSA issued a press statement on 2 September 2011 (http://www.fsa.gov.uk/pages/Library/Communication/PR/2011/078.shtml) stating: *“The Tribunal determined that Mr Geddis committed market abuse”*.

17. This was not the issue that the Tribunal was determining. As the Tribunal said in its judgment (http://www.tribunals.gov.uk/financeandtax/Documents/decisions/JasonGeddis_v_FSA.pdf) at paragraph 41: *“It is also not in dispute that Mr Geddis’s conduct … amounted to market abuse”*. The question which the Tribunal had been asked to determine was the level of the fine, not whether market abuse had been committed—it was accepted by the Tribunal that it was a mistake by Mr Geddis (who had an unblemished 20 year record as a trader), rather than deliberate misconduct. The Tribunal went on to say that: “*The Authority has not satisfied us that Mr Geddis demonstrated a lack of integrity. On the contrary, we find that he is a person of integrity.*” and “*the Authority misjudged the facts of the case and misjudged Mr Geddis*”.

18. The Tribunal also noted that as a result of the FSA investigation Mr Geddis lost his job and was unable to find suitable alternative employment. Yet despite the finding that Mr Geddis was fit and proper and the criticism of the FSA’s approach, the press statement put out by the FSA contains no hint of contrition that they had done Mr Geddis any wrong.

19. In another case, the FSA announced on 1 June 2010 that Mr Rambourg a well known fund manager with Gartmore was under FSA investigation as well as Gartmore itself. The result was that Gartmore was sold for a fraction of its share price as at the date of that FSA announcement and it was left to Mr Rambourg himself to announce several months later on 29 March 2011 that he and Gartmore had been cleared of any

[47] Mark Hoban MP before the Treasury Select Committee on 30 November 2010

wrongdoing by the FSA. The FSA made no announcement other than to confirm what Mr Rambourg had said. Only last week it was announced that Mr Rambourg had decided to set up his next business venture, one of the largest hedge fund launches in years in Paris, not London.

20. The only arguments put forward by the CEO of the FSA for retaining statutory immunity when he was examined by the Treasury Select Committee were:

20.1 If immunity was removed and the authority is found to have acted negligently, so that a person has suffered loss, who would pay for that person's loss?

20.2 If the authority can be held liable when it acts in a way that is negligent, that might put people off becoming regulators.

21. These arguments were quite rightly dismissed by the Chairman of the Treasury Select Committee as not being answers to the question at all.

22. In the first instance the FCA could take out a policy of professional indemnity insurance with a leading insurance company: just like every firm which it regulates, as well as every law firm and many other institutions have to do. That way, if the regulator is found to have committed an act of gross negligence, it is able to compensate the victim of its negligence through the insurance policy, without having to impose an additional levy on the firms which it regulates.

23. This ought not to be unduly expensive for the firms whose fees fund the FCA. We have spoken on an informal basis to several insurers. They have all agreed that negligence by the regulator would be an insurable risk that could be covered by a policy. The amount of premium required each year would also be a form of independent audit check of the efficiency of the current systems and controls of the regulator and its performance to date.

24. Almost every organisation in the UK is liable for negligence if they fail in a duty of care, with the exception of the UK's financial services regulator. Such liability acts as a deterrent to organisations like the NHS, the police and other public agencies to guard against acts of gross negligence and/or recklessness. It does not put people off from working for these organisations.

25. It would also encourage the regulator to introduce working practices to guard against negligence by its staff. It would therefore lead to better efficiency and higher standards, as the insurer will want to see these steps taken in order to price the premium. It would introduce a layer of commercial accountability to an independent third party.

26. In the absence of a statutory immunity against damages actions, the only realistic course of action for a person aggrieved by the FSA is a complaint. However, for the reasons identified by the authors of *Leviathan at Large*, the current FSA complaints scheme is not fit for purpose. Neither has it sufficient independence from the FSA nor powers to hold the FSA to account. The reforms proposed by *Leviathan at Large* should be enacted together with ensuring the ability of the independent complaints scheme to award significant ex gratia payments should that prove justified.

Widening of Scope of Judicial Review

27. Likewise, the authors of *Leviathan at Large* were correct to identify the current inadequacies in the judicial review remedy. Since 2001 there has only been one successful judicial review (in which this firm acted) of the FSA in relation to its own initiated investigation.[48] This was on a point of law whether certain documents were legally privileged. No judicial review in relation to the FSA's exercise of its powers has been allowed. Unless there is a widening of the scope for judicial review with a statutory obligation on the FSA to act in a way which is fair, reasonable and proportionate, the FSA (or its successor) can not be held accountable through judicial review.

Ability to Recover Costs

28. As noted above, if the FSA is to be held accountable through the Tribunal process then there should be some form of financial assistance to do so for individuals or at the very least the presumption that costs will be awarded if a successful challenge is made. Otherwise there are very few individuals who will have the financial ability to do so when their legal costs will not be met even if they win.

Current Legislative Proposals

29. The current legislative proposals will make the FCA less accountable. For example:

29.1 Hearing appeals against some enforcement decisions on more limited grounds for appeal;

29.2 The ability of the FCA to publish warning notices.

[48] The Queen (on application of Mr Stewart Ford) v FSA [2011] EWHC 2583 (Admin)

Removal of Right of Appeal

30. The hearing of appeals against some enforcement decisions on more limited grounds for appeal is intended to be equivalent to those raised on judicial review. Given the concerns already expressed above about the extremely limited ability to mount a successful judicial review, it appears that this is intended to effectively take away the right of appeal.

Publication of Warning Notices

31. Warning notices are by their very nature given at the very outset of any action being taken by the FSA, long before a decision is reached, if indeed a decision is reached at all. On occasions, warning notices do not lead to a decision but are simply discontinued. The FSA's own statistics indicate that one in five of all FSA warning notices issued to end of 2010 did not result in a decision notice.[49] In other words, some 20% of all FSA warning notices had they been publicised under this proposal would have been wrongly publicised.

32. In the one case where there has been a successful judicial review had the FSA had the right to publish a warning notice, it could have exercised it to take away the confidence in the legally privileged documents and thwart any ability to make what a High Court judge has found to be a valid judicial review.

33. It also heightens the concerns expressed above about the ability of the FSA to damage the reputation of a regulated firm and/or individual on the basis of preliminary grounds which are later found to be without substance. The example of Mr Rambourg and Gartmore suggests that the FSA should have less ability to publicise its investigations rather than more.

34. It also underlines that there ought to be a positive obligation on the FSA (and its successor) to publicise it has found no wrongdoing when it has given any cause for doubt over a firm and/or individual's reputation. The FCA's Complaints Commissioner should also be asked to police the FSA's issue of press releases and if necessary issue its own press release to ensure fairness and equality of arms is achieved.

Need for an Independent Investigation of Regulatory Failure

35. In the event of a regulatory failure, an independent third party should investigate what the FCA did wrong rather than as is currently proposed the FCA. That it is proposed the FCA should be allowed to investigate its own failings serves to underline the current lack of accountability.

36. Instead we should return to the pre Financial Services and Markets Act regime where an independent third party, the Parliamentary Ombudsman could investigate whether the FSA had been guilty of maladministration as it can still to do so with Government departments and public services. Without such mechanism, there has been no opportunity to investigate the performance of the FSA since Equitable Life where the material events in question had to pre-date 1 December 2001.

Need for Openness and Transparency

37. Finally, the Government's emphasis on the need for openness, clarity and transparency of the new regulators is welcome. The new regulators ought to be subject to an equivalent disclosure requirement as the firms and individuals they regulate to be open and co-operative and to disclose anything relating to the regulators of which the regulated firms and individuals would reasonably expect notice. At present, there is a double standard that the FSA has sought to exploit since it has become more intensive, intrusive and litigious in its approach.

38. In this regard, it would be welcome if the FCA could be required to provide guidance on request so that it is clear what the FCA's expectations are.

October 2011

Written evidence submitted by the Finance and Leasing Association

Executive Summary

1. The FLA shares the Treasury Committee's view that the FCA should have a primary duty to promote competition.

2. We also favour a proportionate and tailored approach to regulation by the FCA. If the FCA takes over the regulation of consumer and small business credit, its starting point must be the fact that, in stark contrast to the deposit markets, the main risk in the credit markets lies with the lender rather than the borrower.

3. Any new regime in the credit markets should therefore be predicated on the recently-implemented Consumer Credit Directive, rather than on the Financial Services and Markets Act (FSMA) in its current form.

[49] Based on the statistics published by the RDC, available at http://www.fsa.gov.uk/pages/about/who/pdf/rdc_stats.pdf , between December 2001 and December 2010 the FSA issued 1,167 warning notices (an average of 117 per year). Over the same period it issued 931 decision notices.

4. The Government also needs to ensure that it devotes enough time, resource and expertise to the planning of any new credit regime, and to the immense task of transferring to it the 100,000 entities currently licensed to provide credit under the existing Office of Fair Trading (OFT) regime.

Introduction

5. The Finance and Leasing Association (FLA) is the leading trade association for the consumer credit, motor finance, and asset finance sectors. Our members include banks and building societies and their subsidiaries, the finance arms of leading retailers and manufacturing companies, and a range of independent firms, many of whom are not banks.

6. In 2010, FLA members provided £72 billion of new finance to UK businesses and households. £52 billion of this was in the form of consumer credit, including 30% of all unsecured lending in the UK, made available via credit and store cards, unsecured loans, store credit, second charge mortgages, and funding for half of all private new car sales. The remaining £20 billion was provided to private and public sector businesses via leasing and hire purchase, funding around a quarter of UK fixed capital investment during the year, including support for 750,000 small and medium-sized enterprises.

7. We are pleased to contribute to the Treasury Committee's inquiry into the FCA. We previously submitted evidence to the Committee's inquiry into financial regulatory reform. The Government's plans have since been fleshed out in a number of ways, although the future of consumer and small business credit (currently regulated by the Office of Fair Trading under the Consumer Credit Act) remains unclear.

8. We would be happy to give further evidence, written or oral, regarding any of the issues raised in our answers to the Treasury Committee's questions, which follow below.

Questions

Are the objectives of the Financial Conduct Authority (FCA) clear and appropriate?

9. Yes, up to a point. The FLA welcomes the recognition that the FCA must discharge its functions in a way which promotes competition. However, we share the Treasury Committee's view that this needs to be underpinned by a statutory objective to promote competition (see paragraphs 10–11).

Should the FCA have a primary duty to promote competition as recommended by the Treasury Select Committee and Independent Commission on Banking? How should this work in practice?

10. Yes. The operational objectives only allow the consideration of competition where it is "compatible" with them. This could lead to a damaging loss of focus on the importance of effective competition for healthy markets. It is important that Parliament holds the FCA to account to ensure that this does not happen, even if a statutory objective is not imposed.

11. A statutory duty would have the advantage of ensuring that the FCA considered the promotion of competition when devising new regulatory frameworks (eg for consumer and small business credit), drafting regulation or taking enforcement action, in the same way that proposed new legislation is subject to an impact assessment.

Does the FCA's approach to regulation, as outlined in the Financial Services Authority (FSA)'s June 2011 document, represent an improvement on that of the FSA?

12. Proportionality is the key. We support the principle in the draft Financial Services Bill that "a burden or restriction which is imposed on a person, or on the carrying of an activity, should be proportionate to the benefits." This will be particularly important if the FCA takes on responsibility for the 100,000 existing holders of credit licences, most of whom are not banks, and 40% of whom are sole traders.

13. The existing Consumer Credit Act (CCA) regime provides certainty for consumers and lenders by setting out explicitly what is expected of credit providers at different stages of the credit life-cycle, and includes extensive—and recently radically-revised—consumer protection provisions. But the very different FSMA-style requirements set out in the Government's December 2010 consultation paper on a new consumer credit regime[50] included a number of proposals which would fail a proportionality test, and which give us particular concern.

14. For example, FSMA-style capital adequacy requirements, designed for the deposit markets where the main risk lies with the depositor, would be wholly inappropriate in the credit markets. Failure of lending companies does not pose a risk to the customer of the kind familiar in the deposit and saving markets. Lenders would effectively be required to hold capital against a customer risk which would never materialise. This would needlessly restrict their lending capacity, and would be likely to drive some companies from the markets altogether and reduce consumer choice.

[50] *A new approach to financial regulation: consultation on reforming the consumer credit regime,* http://www.hm-treasury.gov.uk/d/consult_consumer_credit211210.pdf , HM Treasury

15. The current FSA Approved Persons regime is onerous, and some existing FSA-authorised firms have struggled to recruit staff willing to be subject to the liability involved. It is simply not clear what benefit the application of such a regime to the consumer and small business credit markets would bring. A much smaller market would be the likely result.

16. The Appointed Representative (AR) regime for intermediaries would be impossible to apply in the very highly-intermediated consumer and small business credit markets. These markets include motor finance provided through dealers (supporting 58% of all UK private new car sales) and high-street credit, where thousands of retail outlets exist. Many intermediaries often work with a panel of lenders, in order to access the best deals for consumers. In practice, lenders would be obliged to restrict the number of businesses through which they provided credit, and there might have to be a "lead" credit provider. FSA regulation of insurance intermediaries (introduced in 2005) resulted in many lenders withdrawing from the market. The introduction of a similar regime in the credit markets would have a serious adverse effect.

17. We are also concerned about the provision of credit to small businesses. Currently, the Consumer Credit Act (CCA) regulates the provision of finance to around 3.2 million of the UK's 4.8 million businesses. This has already had the effect of creating two parallel regulatory regimes for business finance, leading to real and costly problems for the FLA's asset finance members who provide finance for both parts of the business community. The special regime for smaller businesses makes little sense, and the protections provided to customers by the CCA offer little, if anything, in addition to what is already provided by the FLA's own Business Finance Code.

18. Moreover, despite the fact that the recent EU Consumer Credit Directive (CCD) specifically exempts business lending, the Government has chosen to apply the CCD regime to all parts of the market currently covered by the CCA. This has involved the FLA's asset finance members in substantial implementation costs, including new agreements with customers, and the procedures and staff to ensure compliance. They are also facing high costs from dealing with customers who are being advised to challenge business agreements on irrelevant technicalities under the CCA regime. As a result, some business finance providers have already decided to cease offering finance to unincorporated businesses.

19. The proposed new FCA consumer credit regime would materially worsen this already difficult situation. New conduct of business rules, layered on top of existing requirements, would significantly increase the cost of lending to businesses, as a result both of the one-off implementation costs and the ongoing compliance burden. This would reduce competition and choice in the market. It would become much harder for small businesses to raise finance for business investment, particularly the tens of thousands of businesses which rely on help from smaller, independent asset finance companies. This could lead to business failures. These adverse consequences would be likely to follow whether the new regime applied only to those SMEs already covered by the CCA (3.2 million) or to the total business population (4.8 million).

20. We therefore believe that any new FCA credit regime should be closely based on the current CCA/CCD regime. This would also minimise the work involved in transferring nearly 100,000 licensed credit providers to the new regime. Secondly, we think the new regime should be concerned mainly with private consumers. If businesses are to be included, the definition should be tightly drawn so as to include only the most vulnerable businesses—those most akin to private consumers—such as unincorporated micro-businesses (as defined by the European Commission) with no more than 10 employees.

To whom should the FCA be accountable? Are the lines of accountability clear?

21. We agree with the lines of accountability set out by the Government in its July 2011 consultation document. But FCA accountability to Parliament will also be important, particularly in the early stages of the regime. We specifically called for this in our recent evidence to the Financial Services Bill Scrutiny Committee.

22. We welcome the proposed duty on the FCA to produce an Annual Report. We would also like to see a requirement on the FCA to publish a draft Annual Plan in consultation with industry and other stakeholders. This would help improve accountability to regulated firms.

Are the powers of the FCA suitable? Will their exercise be subject to appropriate scrutiny? How should the FCA be interacting with industry as well as using its intervention powers?

23. The proposed FCA powers to ban products are worrying, and would have serious implications for consumer and small business lenders if they became subject to a new FCA regime. This would be particularly so if regulatory action of this kind were taken some time after a product had been brought to market, and perhaps achieved significant consumer take-up. There would also be a risk of business failure where firms offered only one product. We are concerned at the apparent absence of safeguards to avoid such outcomes. While we agree that firms should have proportionate measures in place to review and evaluate new products, including their cost and distribution, as well as to monitor how products operate in practice, any requirement for pre-approval would stifle product innovation, competition and lead to delays in delivering services to consumers.

24. The FLA also remains concerned that early disclosure of a Warning Notice—as proposed—could leave consumers confused and unsure as to what action they should take if they have an account with the company

concerned. We believe that any such publication should be delayed until any appeals process has been exhausted. Inappropriate action in response to a Warning Notice could leave the credit customer disadvantaged if a Notice of Discontinuance was subsequently issued.

25. It will be important for the FCA to engage early with the companies concerned, and with the industry at large if there are wider ramifications. We support regular informal dialogue between the industry and the FCA, especially during the early stages of the latter's existence to ensure that emerging issues are resolved efficiently.

How will the break-up of the FSA work in practice? Issues of coordination and information sharing between the FCA and the Prudential Regulation Authority (PRA)

26. This question should also take account of the Government's parallel plans to abolish the Office of Fair Trading (OFT), which we assume is one of the drivers of the proposal to transfer consumer credit regulation to the FCA.

27. As we pointed out in our earlier evidence to the Treasury Committee inquiry into financial regulatory reform, it is not currently clear that the FSA, OFT or the relevant Government departments are resourced adequately for the formidable task of planning and executing the transition to the new regime. This is particularly true in the area of consumer and small business credit. If the regulation of consumer credit is transferred to the FCA, the new regulator will need a detailed knowledge of the credit markets and the extensive UK and EU legislation and regulation which currently governs them. It will also require the necessary resources to ensure an orderly transfer of nearly 100,000 regulated credit suppliers to a radically different regime. Given the scale of the task, we estimate that the project may take five to seven years to complete, bearing in mind that the last revision of the Consumer Credit Act—a much less radical exercise—took four. The Government needs to do the detailed planning necessary to ensure the sourcing and effective deployment of the skills and expertise needed, for what could be the biggest regulatory upheaval in the credit markets for a generation.

28. It is also essential that machinery is created to ensure that coordination between the FCA and the PRA works well in practice. Equally important is the need to avoid unnecessary duplication of regulatory requirements or—worse—inconsistencies of approach, which could impose unnecessary costs on regulated businesses. We therefore support common approaches to authorisation, rule-making, reporting, and supervision.

29. The draft Bill provides for an annual review of the memorandum of understanding between the PRA and FCA. We believe that this should contain a provision ensuring that if the PRA's power of veto over the FCA is used other than on an exceptional basis, a review of the relationship between the two bodies should automatically be triggered, with the aim of ensuring more effective cooperation.

How should the FCA be interacting with other domestic regulators? For example, the FCA's relationship with the Bank of England and Financial Ombudsman Service

30. We welcome the Government's view that the Financial Ombudsman Service "should be able to focus on processing individual complaints on a case-by-case basis rather than having to lead the way on mass issues."[51] We acknowledge that the FOS and other parties will have a role to play in identifying trends in complaints, but it is important that the Government sticks to its commitment to give the FCA the final say in determining any action.

31. Under the current arrangements, firms have often found it difficult to keep track of changes to FSA regulatory requirements, some of which—for example—have been publicised simply by inclusion in speeches by FSA employees. This is a highly unsatisfactory and disjointed approach and should be discontinued by the FCA. If the Financial Policy Committee wishes to make similar regulatory announcements, they should be required to notify regulated firms formally and directly.

How should the FCA be interacting with international regulators? Do EU regulation initiatives restrict or enhance the work of the FCA? Will the FCA be able effectively to engage with the EU supervisory authorities?

32. The UK's freedom of action in the consumer credit markets is restricted by the recent EU Consumer Credit Directive (CCD). The CCD was implemented in the UK as recently as February this year, following extensive work in finalising the domestic legislation and putting the new regime in place. The CCD restricts the scope for taking a completely new approach to credit regulation.

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[51] p.33, *A new approach to financial regulation: the blueprint for reform* http://www.hm-treasury.gov.uk/d/consult_finreg__new_approach_blueprint.pdf

Written evidence submitted by the Association of Investment Companies

1. The AIC welcomes the opportunity to provide its views on the establishment of the Financial Conduct Authority (FCA). The AIC's submission is focussed on two issues raised in the call for evidence:

- Are the objectives of the FCA clear and appropriate?
- Should the FCA have a primary duty to promote competition?

Executive Summary

2. The AIC *agrees* that establishing a "tiered" structure which establishes the duties and objectives of the FCA, as proposed by the draft Financial Services Bill, will create an effective and appropriate framework for the FCA to discharge its duties.

3. The AIC *agrees* that the proposed strategic and operational objectives proposed for the FCA are appropriate and will set a suitable framework for regulation.

4. The AIC *recommends* that the FCA should not have a primary duty to promote competition: this should be a secondary consideration for the regulator.

5. The AIC also *recommends* that the current duty to promote competition should be clarified so that it prioritises promoting competition in the consumer interest. That is, competition which will secure market determined prices and higher service and product standards. The FCA's duty to promote competition should be allowed to provide any threat to appropriate regulatory standards required to achieve its strategic objective.

Overview of Investment Company Current Regulatory Arrangements

6. Investment companies invest in a diversified portfolio of assets to provide a return for their shareholders. Their own shares are traded on public markets and the vast majority of our members are listed on the London Stock Exchange. These companies are subject to the Listing Rules and the Disclosure and Transparency Rules and are therefore regulated by the FSA in its capacity as the UKLA.

7. Following the implementation of the AIFM Directive all investment companies will be regulated in the UK by the Financial Conduct Authority (FCA).

8. As the debate on reforming the UK's regulatory regime has progressed the AIC has argued that the FCA should act as both the UKLA and the competent authority for the AIFM Directive. This will locate responsibility for all of an investment company's financial services regulatory obligations in one place. The AIC therefore welcomes the Government's decision to adopt this approach.

9. The AIC also supports the Government's decision to locate the complementary activities of oversight of investment exchanges and market abuse within the FCA. This will create the basis for a strong and coordinated regulatory oversight able to maintain confidence in UK financial markets.

10. Investment companies have other regulatory obligations which arise by virtue of their corporate structure. These derive, for example, from company law and accounting rules. As with other companies undertaking regulated functions and activities, these will—rightly—not fall under the FCA's auspices.

11. The AIC represents investment companies and their shareholders. This orientation towards the needs of shareholders is an important element in determining the AIC's view and increases the prominence of the "consumer" interest in our recommendations.

Overall Structure of the FCA's Regulatory Duties

12. The draft Financial Services Bill proposes that the FCA's regulatory duties should be organised in a tiered structure. The hierarchical approach proposed provides the basis for a sound regulatory framework.

13. The FCA's top-tier obligation will be to deliver a strategic objective of protecting and enhancing confidence in the UK financial system. Recent market failures have amply illustrated the value of this objective and its wider importance to the UK's economy. Achieving this objective should drive all the FCA's activities.

14. Alongside this strategic objective, the FCA will have a duty to also advance three operational objectives encompassing: consumer protection, the integrity of the UK financial system and advancing efficiency and choice. The AIC *agrees* these are suitable operational objectives of the FCA. It is appropriate for them to sit alongside the strategic objective at the top tier of the regulatory framework.

15. The FCA's operational objective of advancing efficiency and choice is important in the context of determining whether or not "promoting competition" should be a primary objective of the FCA. The AIC *recommends* that "promoting competition" should not be promoted to a primary, or top-tier, objective of the FCA.

16. Advancing efficiency and choice will require the FCA to ensure that its regulatory activity does not erect inappropriate barriers to market entry or product development as this will restrict choice. The FCA will also

have to guard against the imposition of rules which unnecessarily increase compliance costs and burdens as this will reduce efficiency.

17. Successfully advancing "efficiency and choice" will mean that rules imposed by the FCA should allow competitive forces to operate within the restraints it has set. The FCA will "hold the ring" in which competitive forces can act. This is an appropriate role for the FCA.

18. The FCA should not have a primary duty to actively promote competition. Regulation inevitably, by its very nature, curbs competitive forces. This is part and parcel of regulating to protect consumers and guarding against market failure. Making competition an explicit, primary objective is therefore inappropriate. Advancing "efficiency and choice" is a suitable alternative.

Clarifying the Obligation to Promote Competition

19. The AIC *agrees* with the Committee's view that healthy competition is an essential mechanism to deliver the best possible consumer outcomes. Competition has the potential to lower prices and improve product and service standards.

20. Given the positive role competition can play it is correct that the FCA should perform its duties in a manner which will promote competition as long as this as compatible with its strategic and operational objectives. For the reasons discussed above, the AIC *recommends* that this obligation is subordinate to the regulator's primary strategic and operational objectives.

21. While the FCA should have regard to competition, the nature of this duty should be clarified. The Committee has previously noted the support the Independent Commission on Banking gave to effective competition. The AIC also endorses this perspective but notes that the Independent Commission on Banking's position was qualified. It said that, "*a distinction is needed between 'good competition' to serve customers well, and 'bad competition' that exploits customer unawareness or, for example, creates a race to the bottom on lending standards*." (Final Report, Independent Commission on Banking. Page 153.)

22. The AIC *recommends* that the nature of the FCA's duty to promote competition should be clarified to reflect a similar distinction between competition which supports positive consumer outcomes and that which does not. In particular, the AIC *recommends* that the duty to promote competition should say that:

> *"The FCA must, so far as it is compatible with its strategic and operational objectives, discharge its general function in a way which promotes competition which will support the consumer interest, particularly through delivering enhanced product and service standards and market-led pricing"* (suggested clarification has been *emphasised*).

23. In the past, discussion of the regulator's impact on "competitiveness" has often focussed on "international competitiveness". While FCA regulation should not unnecessarily impede the international position of the UK's financial services sector, this should be a subordinate consideration to the consumer orientated competition discussed above.

24. Taking this approach will ensure that the FCA's regulatory effectiveness is not compromised by any suggestion that it should seek to erode standards to enhance the competitiveness of the UK as an international financial centre. The AIC is keen to see the UK's financial services sector flourish and believes that it is exceptionally well placed to do so. It enjoys many benefits including the skills and experience of existing providers, the City's track record of innovation, language and geographical position (located between key Europe and North American markets).

25. However, an effective regulatory system is an important platform which helps to maintain and enhance the UKs competitiveness in financial services. Regulation which delivers investor confidence which in turn attracts business to the UK. Maintaining confidence is rightly already encompassed in the FCA's top-tier strategic objective.

26. Not qualifying the FCA's obligation to promote competition as set out above creates the risk that calls to reduce standards to make the UK more "competitive" will gain inappropriate traction in future regulatory debates. This creates the potential for downward pressure on the quality of the UK's regime and could undermine the FCA's ability to achieve its strategic objective.

27. The fact that a competing regulatory jurisdiction maintains lower standards does not provide a regulatory justification for the UK to adopt a similar position. Nevertheless, the AIC has experience of these arguments being used inappropriately to try and influence regulatory debates.

28. In 2006 the UKLA was exploring options to reform the Listing Rules governing investment companies. The AIC supported imposing rules to ensure market confidence and deliver shareholder protection in the listed investment company sector. It proposed, for example, that investment companies should publish an investment policy giving investors a clear view of the strategy of the company and the risks it is exposed to. The AIC considered this an essential element of maintaining confidence in the listed sector. Rules of this nature would help attract both UK and international investors. This would help deliver sustained demand for investment company shares and enhance liquidity. (Of course this would not prevent other investment companies adopting alternative routes to trading their shares, for example, through the Specialist Funds Market or AIM. However,

where entrance to the UK's Official List is concerned, the AIC considered that investors expected a higher baseline of standards to maintain their confidence in the system.)

29. The AIC's position was opposed by market participants who noted that lower listing standards are allowed under the Listing Rules established by European legislation (via the Consolidated Admissions and Reporting Directive). A key argument against the AIC position was a claim that imposing higher requirements on a UK listing would erode the UK's "international competitiveness".

30. After a lengthy debate the FSA eventually supported the AIC's position but the result was far from a forgone conclusion. Those supporting lower standards were powerful market participants with a short-term interest in lower standards. On the other hand, those likely to take a long-term perspective and favour higher standards in the investment community were more diverse and dispersed.

31. The AIC is confident that the higher standards imposed in the UK have had a long-term beneficial impact and enhanced the competitiveness of the UK as a venue for listing investment companies. In the aftermath of the debate a few investment companies did chose to adopt the listing standards offered under the European minimum by listing on Euronext. However, as understanding of the standards offered in both regimes evolved, virtually all these companies either returned to a UK listing or took a dual listing.

32. Since September 2007 (when the new rules were introduced) only 2 investment company IPOs have listed on Euronext. In contrast, 33 IPOs have listed under the higher regulatory standards imposed in the UK. We are confident that the regime in the UK has helped attract business and enhanced its competitiveness, not eroded it.

33. Another example of higher UK standards supporting investor confidence is the regime for disclosing major shareholdings in listed companies. The disclosure of changes in the amount of shares a particular investor holds in a company is an important element in price formation. It allows the market to understand when a shareholder is increasing or reducing its position and, therefore, its ability to influence critical issues of strategy or governance. It also indicates if a shareholder is in a position to take control of or launch a takeover bid for a company.

34. The UK rules require disclosure where a shareholder owns 3% of a company's stock. Further disclosures must be made when their shareholding increases or decreases by a percentage point. EU rules establish a similar obligation but disclosures are only required when an investor owns 5% of the shares and when their position breaches ownership positions representing 5% increments. Therefore, an investor increasing their position in a company where the UK rules apply would have to disclose at 3%, 4%, 5%, 6% and so on. An investor increasing their stake in a company where the European rules apply would have to disclose at 5%, 10%, 15%, 20% and so on. The UK's regime provides significantly more information to the market, which enhances investor confidence.

35. The existence of a "lighter touch" regime in Europe has led some to suggest that the UK rules should be relaxed to avoid compromising UK competitiveness. Thankfully the FSA has recognised the view of investors who support higher standards. The capacity of the regulator to take such a view would be reduced if there was any suggestion that promoting international competitiveness was part of their duties. This concern arises even if the FCA's competition is a secondary duty—it would be overwhelming if it were a primary, or top-tier, obligation. This risk is compounded as the investor perspective is often more disparate (including internationally dispersed) and less well organised than some of the institutions with an appetite to secure short term commercial benefit from lower standards.

36. While lower standards may seem attractive in the short term, when they fail to protect against market failure or do not prevent harm to consumers they have long term negative ramifications which undermine the interests of the financial services sector. The regulatory system should have no pressures which could make it vulnerable to such arguments. This should be made clear by clarifying that the FCA's competition obligations are primarily concerned with promoting competition in the consumer interest.

Securing the Correct Regulatory Outcome

37. Too often regulatory activity is characterised as being "good" or "bad" depending on the perspective of the commentator. In fact effective regulation should provide benefits to all market participants. Consumers will be protected from poor standards. The broader marketplace will be insulated against market failures and systemic collapse. Firms selling products and services will benefit from increased confidence and enhanced demand for the products or services they offer.

38. This outcome will be achieved if the FCA regulates only to the extent required to deliver its regulatory objectives and no more. The regulatory framework established for the FCA should also support this outcome as it includes a requirement for the FCA to act in a proportionate manner. That is, the FCA is required to ensure that the burden or restriction implied by a regulatory intervention is proportionate to the benefits that it will secure. The principle of proportionality is critical to creating an effective regulatory framework and is one the AIC fully supports.

39. If implemented effectively the framework established should deliver an appropriate regime for financial services sector and the broader public and economic interest. It should establish standards of the quality

required to deliver the FCA's strategic and operational objectives and allow competition to operate within the regulatory boundaries established. It will also support the UK's ambition to be an internationally competitive and attractive regime for financial services. This outcome is deliverable without creating a primary duty for the FCA to promote competition.

October 2011

Written evidence submitted by Zurich Financial Services

1. About Zurich Financial Services

1.1 Zurich Insurance plc and Zurich Assurance Ltd are part of the Zurich Financial Services Group (Zurich) which has strong UK interests. Zurich is an insurance-based financial services provider with a global network of subsidiaries and offices in North America and Europe as well as in Asia-Pacific, Latin America and other markets. Founded in 1872, the Group is headquartered in Zurich, Switzerland.

1.2 Zurich employs approximately 7,500 staff in the UK, with large sites in Birmingham, Cardiff, London, Farnborough, Swindon, Cheltenham and Whiteley. It supplies personal, commercial, life and public sector insurance through a variety of distribution channels.

1.3 Zurich is an FSA-regulated major insurance and risk management solution provider for individuals, small and mid sized businesses, large corporations and major multi-national companies in the UK.

2. Executive Summary

2.1 Zurich welcomes the creation of the FCA and its overall objectives in seeking to protect and enhance confidence in the financial system through securing protection for consumers and promoting choice, efficiency and integrity in the Financial Services market.

2.2 There are many positives in the proposals for the FCA. In particular, Zurich welcomes the creation of the new regulatory framework as part of the Government's ongoing efforts to support the UK's influence of harmonised and competitive Financial Services in Europe, particularly on issues such as Solvency II. The proposed seniority arrangements between the FCA and PRA are also welcome. The decision to make the PRA's view decisive on areas where opinions between the regulators differ will be especially important with regards to matters where proposed FCA regulation may threaten the solvency of some firms.

2.3 In order to best deliver on its stated aims, it is vital that the Government continues to actively consult and engage with Industry during the planning stages, and that this "culture of inclusion" is carried through into the FCA's day-to-day approach to regulation. For example, in order to inform its duty to promote competition, regular engagement with Industry through observational membership of key organisations representing the City, such as CityUK, would be recommended.

2.4 Clear definition of the FCA's roles and responsibilities regarding its key objectives will be required. This includes the prevention of financial crime and the role of the FCA vis-à-vis other agencies involved with addressing this issue. It also concerns the duty to promote competition, which may require a clear legal basis in order to allow the FCA to carry out its function.

2.5 Confidence in the Financial System is a key shared priority of both Government and Industry, which should follow a consensus-based approach. In particular, this requires an appropriate mechanism to ensure Industry's involvement and input to the regulatory development process. Zurich believes this would be best achieved through an improved "Issues with wider implications process", as opposed to the Treasury's envisaged replacement, the Co-ordination Committee, consisting of the FSA, the Ombudsman and the OFT, which appears to involve little direct input from Industry itself.

2.6 Transparency in regulation will also help keep Industry informed, and to this end requiring the new regulator to publish training materials for supervisors would give Industry reassurance that issues were being approached on a consistent basis.

2.7 Zurich is confident that the FCA's proposed powers are suitable to allow the regulator to achieve its stated aims. Improvements can be made by adding further clarity and certainty to some areas of regulation, for example the 15 year long stop for advisers, recommended by the Treasury Select Committee. Zurich also feels that the FCA's remit should be extended to Claims Management firms.

2.8 When exercising its powers, Zurich feels that the FCA must also be mindful of acknowledging the successes achieved by Industry in its efforts to self-regulate. Explicitly recognising and publicising the change in culture achieved by initiatives such as Treating Customers Fairly can help the FCA in its overall aim of building higher levels of confidence in the financial system. To this end, Zurich feels that the FSA's plans for product intervention should only apply to firms that do not adhere to Treating Customers Fairly's requirements.

2.9 Careful planning will be required to ensure that an effective working relationship is quickly established between the FCA and other regulators. With particular reference to the PRA, it will be necessary to get the balance right to ensure co-ordinated regulation, avoiding the unintended consequences of conflicting dual regulation for those firms falling under the remit of both bodies. Similarly, the FCA will need to ensure a strong dialogue with the PRA, in order to allow the former's interests to be effectively represented on the European stage.

3. Response

3.1 Q1. *Are the objectives of the Financial Conduct Authority (FCA) clear and appropriate?*

3.2 Zurich welcomes the overall objectives of the FCA in seeking to protect and enhance confidence in the financial system through securing protection for consumers and promoting choice, efficiency and integrity in the Financial Services market. The FCA's objectives are appropriate to this end and are sufficiently clear. However, it will be important that Government continues to actively consult and engage with Industry during the planning stages, and that this "culture of inclusion" is carried through into the FCA's day-to-day approach to regulation.

3.3 With regards to its statutory objective to help combat financial crime, it will be important that the FCA has clearly defined boundaries and responsibilities, particularly within the context of its relationship with other financial crime authorities.

3.4 Q2. *Should the FCA have a primary duty to promote competition as recommended by the Treasury Select Committee and Independent Commission on Banking? How should this work in practice?*

3.5 As a market leader in the Financial Services sector, Zurich welcomes the FCA's primary duty to promote competition as a vehicle to securing the best deal for consumers, as well as encouraging higher standards, integrity and self-regulation in the market. In practice this may require a clear legal basis with which to allow the FCA to carry out this function.

3.6 Operationally, a regular dialogue between the FCA and organisations representing the City would be recommended. This includes TheCityUK which covers banks, investment managers and insurers and meets quarterly to discuss cross-sector issues and particularly the competitiveness of the UK as a financial centre. Its remit includes looking at the impact of EU proposals which will be an important role for the FCA going forward particularly as increasing amounts of Level 3 decisions will be taken by the EU Supervisory bodies.

3.7 The FCA could engage with such organisations as an observer.

3.8 Q3. *Does the FCA's approach to regulation, as outlined in the Financial Services Authority (FSA)'s June 2011 document, represent an improvement on that of the FSA?*

3.9 The FCA's fresh approach to regulation is welcome and can be of benefit to the UK Financial System as a whole. In particular, the retention of an advisory function on issues such as best practice, as well as product intervention powers, will be important.

3.10 However, there are some elements which could be improved upon further. For example, while a benefit of thematic review is likely to be enabling greater understanding of market issues by FCA staff, requiring the new regulator to publish training materials for supervisors would make the supervisory process more transparent and give the Industry reassurance that issues were being approached on a consistent basis.

3.11 Q4. *To whom should the FCA be accountable? Are the lines of accountability clear?*

3.12 The FCA's identified lines of accountability, namely to Government and Parliament, and thus ultimately to the public, are both appropriate and clear. However, in order to make regulation as effective as possible, Industry must also be able to hold the FCA accountable for the decisions it takes. With this in mind, great care must be taken to ensure an "effective appeals mechanism" for those subject to regulatory decisions, as envisaged by the FSA's recent FCA approach document.

3.13 More detail on the recommended form of effective appeal can be found below.

3.14 Q5. *Are the powers of the FCA suitable? Will their exercise be subject to appropriate scrutiny? How should the FCA be interacting with industry as well as using its intervention powers?*

3.15 The powers proposed for the FCA are suitable in seeking to achieve its overarching objectives, which are welcomed. There is, however, scope to improve these powers further. For example, the Treasury Select Committee's recommendation to build a 15 year "long-stop" for Financial Advisers would bring a greater level of clarity and certainty to regulation in this area. It would also bring advisers more into line with the regulatory environment which applies to lawyers. Zurich also recommends extending the FCA's remit to Claims Management companies.

3.16 When exercising its powers, Zurich feels that the FCA must also be mindful of acknowledging the successes achieved by Industry in its efforts to self-regulate. Explicitly recognising and publicising the change in culture achieved by initiatives such as Treating Customers Fairly can help the FCA in its overall aim of building higher levels of confidence in the financial system. To this end, Zurich feels that the FSA's plans for product intervention should only apply to firms that do not adhere to Treating Customers Fairly's requirements.

3.17 As regards scrutiny of the FCA's powers in its interaction with Industry, it is vital that an appropriate mechanism is established to ensure Industry's active involvement and input, in order to create a consensus-based regulatory approach. Zurich feels this would be best achieved by reinstating an improved "Issues with wider implications process", where firms could take ground-breaking issues that had arisen from individual complaints to the Ombudsman and have them examined in more detail by the regulator. This is as opposed to the Treasury's envisaged replacement, the Co-ordination Committee, consisting of the FSA, the Ombudsman and the OFT, which appears to involve little direct input from Industry itself.

Q6 3.18. *How will the break-up of the FSA work in practice? Issues of coordination and information sharing between the FCA and the Prudential Regulation Authority (PRA)*

3.19 Overall, Zurich is in favour of the proposed co-ordination and information-sharing arrangements proposed by the FCA, in particular the decision to make the PRA's view decisive on areas where opinions between the regulators differ. This will be especially important in instances where the FCA would be minded to impose a regulatory review that could threaten the solvency of some firms.

Q7 3.20. *How should the FCA be interacting with other domestic regulators? For example, the FCA's relationship with the Bank of England and Financial Ombudsman Service*

3.21 Zurich believes that the most important part of interaction, particularly with the PRA, will be ensuring co-ordinated and consistent regulation for firms who are regulated by the FCA alongside another regulator. Careful planning will be required to ensure that co-operation and co-ordinated working is quickly achieved, to avoid the unintended consequences of conflicting dual regulation.

Q8 3.22. *How should the FCA be interacting with international regulators? Do EU regulation initiatives restrict or enhance the work of the FCA? Will the FCA be able effectively to engage with the EU supervisory authorities?*

3.23 As the FCA will not be directly represented on EIOPA, it will instead be important that the FCA clearly communicates its position via the PRA, who will be present, and that an effective working relationship between the FCA and PRA is established to allow this.

October 2011

Written evidence submitted by Alastair Lyon, Credenda Ltd

Direct costs FSA+FOS+FSCS—3% of turnover.

Indirect costs Compulsory Professional indemnity insurance, compliance consultancy services—5% of turnover.

Total 8% of turnover.

Plus this year another cost that I regard as a direct cost and that is the costs of achieving the extra exam qualifications which I need which if I account for my own time at my standard fee rate I would estimate to be a one off 15% of turnover.

Reverting to the direct costs, then I believe there is a total disproportion between my 3% (or 18% in the current year and the percentage costs paid by the likes of Aviva, the Pru, Barclays etc. I have in the past tried to find out what their costs are as a percentage of turnover without success but suspect it is miniscule compared with those of an IFA.

I firmly believe that costs should be shared equitably. The costs paid by all authorized firms should be closer to the same percentage of turnover than I believe that they are today. There are comments from the FSA to the effect that they accept that IFA's are paying too high a proportion of costs but very little is being done about it in comparison to the major changes I believe would be needed for more equitable distribution of costs.

October 2011

Written evidence submitted by the Financial Ombudsman Service

1. The Treasury Committee has invited written submissions to its inquiry into the Financial Conduct Authority. The Financial Ombudsman Service welcomes the opportunity to contribute to the committee's evidence.

About the Ombudsman Service

2. The Financial Ombudsman Service is the statutory-based scheme for the resolution of complaints between financial businesses and their customers. It was established formally under the Financial Services and Markets Act 2000 (FSMA) but is based on several predecessor schemes, most of which were established by industry.

Its principal function is to resolve disputes between financial businesses and their customers quickly and with minimal formality. It is an impartial body, which provides an informal alternative to the courts and is funded entirely by the industry through an annual levy and individual case fees.

3. In 2010–11 the ombudsman service dealt with 1,012,371 initial enquiries and complaints from consumers. Of these, 206,121 were referred to the service's adjudicators and ombudsmen for further dispute resolution work. Of these, just over half (104,597) were about payment protection insurance, 65,063 were about banking and credit, 20,978 were about insurance other than payment protection insurance, and 15,483 were about investments and pensions.

4. The ombudsman service has a discrete role—it does not act as a regulator, a consumer champion or reflect the interests of businesses. Its functions are complementary to, but significantly different from, other bodies in the wider regulatory framework such as the Money Advice Service and the Financial Services Compensation Scheme.

The Committee's Questions

5. While most of the committee's questions go beyond the remit of the ombudsman service, we would like to make some observations in response to the following question:

How should the FCA be interacting with other domestic regulators? For example, the FCA's relationship with the Bank of England and Financial Ombudsman Service

6. The ombudsman service is not a regulator, although it plays an important part in supporting the regulatory framework. It provides a back-stop in those circumstances when regulation has been unable to prevent conduct failings and therefore underpins consumer confidence in the market. When the FCA is created it will have powers to determine the overall jurisdiction of the ombudsman service, including the financial activities it covers, the complainants covered and the time limits which apply—as the FSA does now. So an appropriate relationship between the FCA and the ombudsman service will be fundamentally important to ensuring that the ombudsman service can function effectively.

7. In our view securing three key elements will achieve this: preserving the independence of the ombudsman service; putting in place strong governance and accountability arrangements; and ensuring that the regulator is able to make use of the insight and intelligence the ombudsman service obtains as a result of handling cases—so that it can address current issues or prevent problems arising in the future.

8. One of the cornerstones of a credible ombudsman scheme is its *independence* of decision making. An ombudsman's licence to operate depends on them being—and being seen to be—genuinely independent and impartial. That means not only being independent of the parties to a dispute, but also being independent of any external parties whose influence might call into question the ombudsman's impartiality—such as politicians, government departments or regulators. We therefore welcome the fact that the draft legislation retains an independent ombudsman service.

9. However, independence of decision making is not inconsistent with strong *governance and accountability.* We have welcomed the proposals in the Government's draft Bill to strengthen the current arrangements, many of which formalise arrangements we have already put in place.

10. Because it handles a large volume of cases, the ombudsman service acquires detailed *insight and intelligence* about the conduct failings which cause complaints—as well as extensive knowledge about the way in which businesses handle the complaints made to them. It is important that this intelligence contributes to the development of both regulatory policy and practice. We have therefore welcomed provisions within the draft Bill which would require us to disclose information to the FCA where it will assist the FCA in advancing its objectives, and the complementary obligation for the FCA to take this information into account.

11. The FCA should then be well placed to intervene proactively and make use of its powers, such as those for s404 redress schemes which are binding on the ombudsman, to tackle consumer detriment.

12. Taken together these arrangements not only secure the appropriate degree of independence for the ombudsman service but also ensure the necessary separation of the roles of the regulator and of the ombudsman.

October 2011

Written evidence submitted by Kingston PTM Ltd

Cost of Regulation

Further to an article I read following your speech at an Association of Private Client Investment Managers and Stockbrokers (APClMS) conference in which you asked about the costs of regulation, I write to give you some idea of these costs but in a slightly different way perhaps than others.

We are a small national IFA firm with a turnover of well over £1 million. We employ 26 members of staff in two offices and of these six are regulated individuals. We advise on £110 million of client assets and are active in the pensions, investments and protection markets. In addition we have a taxation and an accountancy division. We have never had any complaints which have required that compensation is required, we are RDR ready (as far as we can be given the lack of clarity from the FSA) and have an excellent compliance record. For example, my wife is Chartered Financial Planner and she complies with the quality standard ISO22222—our commitment to quality and service. The firm's hourly charge rate for a Chartered Adviser is £150 per hour. Incidentally and unusually amongst IFAs, we keep timesheets and record how much time we spend on different activities. It makes it easier to calculate the true cost of regulation.

The problem in breaking down costs is that some degree of regulation is actually good business practice which any responsible firm should expect to pay. What is reasonable and what is unnecessary or excessive? Therefore I do feel that you have asked an almost impossible question to answer since it is so easy to criticise figures so provided. So rather than give meaningless figures (which I can in any case easily provide if necessary), I have instead broken down the costs to our clients in a format that might be more akin to Ryan air but is transparent and makes a very good point. Imagine it being presented to a client following an initial meeting and an assessment of the work required—9 hours work.

Adviser hourly charge: (To cover salaries, insurances, provision of facilities, rates, profit, training, compliance etc)	*£130.00*
Plus....	
FSA / FSCS Fees	*£4.71*
TCF Monitoring	*£1.40*
Regulatory Reporting	*£1.12*
Provision for Capital Adequacy proposals	*£6.70*
Preparation far and implementation of RDR	*£7.00*
Hourly Charge (excluding VAT)	*£150.42*

Mr Client, we would estimate that to provide the service you have asked us to provide will take 9 hours plus one further hour to check, record and ensure a compliant advice process to satisfy the FSA and provide the necessary audit.

Adviser Bill:	*£1,170.00*	*(£130*9 hours)*
FSA related costs:	*£334.20*	*(22% of client's final bill)*
Total:	*£1,504.20*	

Please note that the £130 per hour adviser charge covers the cost of PII, best business practice /compliance and therefore an element of regulatory cost. You could also argue that some of the FSA related costs protect the firm against claims chasing solicitors as well as FSA retrospective action but I have tried to allow for this in the £130 per hour base cost.

Another very irritating cost not mentioned is the manner in which the regulator insists that a firm's business model is irrelevant as far as the FSA is concerned. I dispute this vigorously and there is a real risk that regulation drives firms to adopt a more expensive business model or one that offers other inherent risks to the consumer. Kingston PTM Limited not only gives regulated advice to a client but that same client may also require tax and unregulated accountancy services. Tax and accountancy services accounts for around 1/3rd of our turnover. To streamline the process and relieve the amount of paperwork a client receives we include all three divisions within the firms structure. It also ensures that we meet the requirements of the Data Protection Act and the FSA's Customer Data Security rules. It is a prime example of Kingston PTM Treating Customers Fairly. Our reward for this is that there is a real risk that our enhanced turnover is used as the basis of calculating regulatory fees. Certainly it is a fact that it has already added unreasonable capital adequacy requirements. Not included in my calculations above, our firm has to find a further £50,000 (in cash) for capital adequacy because we give both regulated and unregulated advice because of our business model, a model which we have chosen because it is fair to our clients and meets our regulatory and statutory obligations. Catch 22.

One final thought to put all this in perspective; a 1% rise in Employer's NI would cost our clients around 15p an hour more.

I trust that these figures prove useful and perhaps explains why clients are struggling to pay for advice.

October 2011

Written evidence submitted by Fiscke plc

The Role and Responsibilities of the FCA

As a member of APCIMS I have been asked by Tim May the Chief Executive to make a submission, should we wish, to your committee.

As a firm of private client stockbrokers existing and operating for nearly 40 years in London I should say from the outset that we have been deeply disappointed with the abilities, the policies and the performance of the FSA. It is obvious that it is inappropriately staffed by people with little knowledge of the industry they are meant to regulate. Their policy is to produce a veritable flood of largely pointless paperwork and to continually revise and add to its plethora of petty rules. Its performance is well known. It failed to spot the split level trust debacle until it had blown up, although Cazenove managed to spot it early on. It failed to spot the 2007–08 banking crisis until it exploded in their face although the warning signs of that crisis were glaringly obvious from February 2007 and certainly widely commented on not least at my firm. They failed to spot the recent Keydata scandal that has cost us all so much in compensation. Now it seems, almost in contradiction to the Conservative promise to abolish the FSA, that the FCA is to be largely staffed by the same people who have failed us so miserably in the past.

What do we want. We want to prevent fraudsters and conmen operating in the City. We want the quality of advice offered to clients, even if not accepted, to be of the best quality. Equally clients must take some responsibility for their actions whether it is depositing money in foreign owned banks or making stock market investments and a check should be put on the compensation culture. The best people to spot is behaviour, whether criminal or not, in the financial services industry are practitioners not lawyers and strong efforts should be made for senior practitioners to be seconded to the FCA for say a two year term either as full time employees or even as part time non executive advisors.

The FCA should be clearly accountable and it should be cost effective and this last point should be transparent.

The most important point of all is that a new start is a new opportunity and as the FSA has lost the respect and trust of its industry every effort should be made to recapture that trust and respect for the new body. It will not be done with the old management.

October 2011

Further written evidence submitted by the Investment Management Association

THE REAL COST OF REGULATION

Summary

The IMA has noted the requests from the Treasury Select Committee for harder evidence about the real cost of regulation. In response, it made a request to a selection of its members to provide cost details in relation to certain aspects of regulation. Responses of differing length and detail were received from 14 of its member firms, themselves all broadly falling into the medium to large category (relative to the IMA membership).[52]

An industry with almost £4 trillion under management in the UK alone cannot operate without proportionate regulatory oversight. However, while a number of firms expressed satisfaction with the regulatory process in the UK, including ARROW visits, there is also a considerable degree of concern in a number of areas:

- The costs of both ARROW and s.166 procedures were felt by a number of respondents to be disproportionate to the value added. Furthermore, such procedures being part of the supervisory set of tools are not subject to cost benefit analysis (CBA) by the FSA, which is limited to rule-making and guidance.
- ARROW visits reportedly amount to around 700–1,500 hours of staff time, incurring total internal quantifiable costs of £300,000–800,000 per firm and external costs of up to £1,200,000 per firm.

[52] In view of the relatively tight timetable, the IMA asked firms to focus on two particular aspects of regulatory process: the ARROW framework and s.166 reports. Where possible, the cost of internal resource was expressed both in monetary terms and in terms of staff time expended. Respondents also reported the cost of external services insofar as these have been used. In addition, the IMA provided an opportunity to firms to provide any other information or comments.
If there was a common theme amongst those firms which provided detail, it was that they would do so only on the basis that it was aggregated and anonymised. That has meant some material has not been included and some detail is necessarily lost. We trust that the Committee understands that this is only a reflection of the huge risk firms feel they take in raising criticisms of the current approach to regulation. Those risks arise first through being regulated but also there are reputational risks. Not least in reputational issues is the concern that firms are not seen as opposing all forms of regulation or of suggesting that regulators should be omniscient.

— The s.166 process is highly resource intensive, in one case requiring 500 hours of internal staff time. External costs start at over £200,000 amongst firms of the type which responded and can be as high as £1,000,000–£2,000,000 per firm.

— With respect to s.166 specifically, there is a concern that the FSA is outsourcing (at considerable cost) risk assessment exercises that could be both better targeted in terms of their focus and better undertaken internally.

— Respondents also expressed concern over the level of expertise and experience of FSA supervisory teams, which often added to the cost. One firm reported that, over the last 10 years, they got a new team at least every 18 months.

— More general comments reflect a range of frustrations, including a lack of common understanding as to why additional capital requirements are set so high.

1. *ARROW*

ARROW (Advanced, Risk-Responsive Operating FrameWork)

Within ARROW, the FSA uses two broad approaches to managing external risks: ARROW Firms and ARROW Themes. The ARROW Firms approach involves assessing and dealing with risks applying to an individual firm or connected firms. Under the ARROW Themes approach, FSA considers specific issues as they affect a number of firms, an entire sector, or the wider market. FSA chooses one or the other of these approaches (or a mixture) to deal with perceived risks.

In terms of the frequency of visits to asset management companies, these may occur every year or less frequently (commonly every two to three years), depending upon the level of impact the FSA deems a firm to have.

Time

Respondent firms generally spent between 700 and 1,500 hours (equivalent to 88 and 188 person days) in total on the various stages connected to the ARROW process; preparation, visit and follow-up. While one firm reported close to 7,400 hours (ie 925 days), this was wholly exceptional.

Each stage of the process required the involvement of a wide range of senior executives at CEO, CIO, CFO and Board level, Executive and Non-Executive Directors, Heads of Legal and Compliance, Internal Audit, Operational Risk, Product Development, Sales and Human Resources. It also included considerable resource from the respective teams as well as back office and other administration staff.

Internal cost

The variety of staff level and tasks involved created difficulties in quantifying the aggregate internal costs. As such, where estimates were provided, they were conservative and excluded less quantifiable elements, such as the cost of responding to ad-hoc requests or the opportunity cost incurred through the reallocation and reprioritisation of resource. Internal staff costs alone were reported to total between £300,000 and £800,000, of which the greatest part was incurred during the preparation and follow-up stages.

As a broader comment, it is worth emphasising that the extensive involvement of senior executives is sometimes overlooked in the analysis of the cost impact of regulation. All aspects of regulatory change require input well beyond that of compliance, risk and legal departments. These costs have to be judged also in terms of opportunity cost, particularly at higher management levels.

External cost

Most respondent firms sought the involvement of external consultancies to assist in the preparation stage. Dependent upon the size and nature of the firm perhaps 20 to 50 individuals were interviewed; some respondent firms prepare extensively for such interviews using external assistance. Law firms were often used for verification of documents during the follow-up process. Where detail was given, the combined cost of these external services came to a reported £400,000 to £1,200,000 per firm.

Further comments

Available feedback did not suggest that the above costs were considered to be entirely unnecessary, but the level of cost and effort was perceived to be excessive when compared to the outcomes and any feedback from the FSA:

> *"While the FSA did give us some opportunity to comment on the wording of the required actions before they were finalised, the process includes no transparent cost benefit assessment of the required actions, proportionality to the risks or the impact of reprioritisation of resources and budgets, for example in relation to IT enhancements and process changes. They therefore carry the risk not just of adding disproportionate cost but of also skewing the prioritisation of control enhancements to areas of relatively less risk."*

In particular, responses suggested dissatisfaction with the appropriateness of the time horizons set by the FSA in the preparation and follow-up stages, which entailed requests that often could not be manned by existing staff without compromising their duties. This in turn increased reliance on the help of external consultants at significant additional cost to the firms:

> *"This was particularly the case with respect to a request to change the methodology applied to the ICAAP calculation for operational risk. The effort spent doing this to a short timescale, as well as obtaining independent validation of the revised approach was considerable. The net outcome is actually a lower capital charge calculation."*

Likewise, high turnover of FSA review teams was seen as adding substantial cost to the process in terms of re-educating new teams and providing documentation:

> *"Preparation includes putting together [over half a dozen] ring binders of information for the FSA [and] also responding to requests for additional information and writing detailed analysis of all our business lines and regulated entities to help FSA's understanding of our business. This was due to a new team being put in place just before the review. We got a new team at least every 18 months in the last 10 years."*

The combined impact of the above substantially added to the financial burden incurred by firms throughout the ARROW process.

2. *Section 166*

> Section 166 of the Financial Services and Markets Act (FSMA)
>
> The FSA can nominate a "skilled person" (usually an auditor from the Big Four) who, in the FSA's view, has the necessary skills to make a report on any matter reasonably connected with the FSA's functions and objectives. The FSA can nominate which auditor is to carry out the "skilled persons" assessment of the firm and the firm must pay for this review. The cost to a medium-sized firm starts at around £200,000 and increases depending on the scale and nature of the review by the audit firm. The audit firm will then present their findings to the FSA, who can then impose a fine and public notification if the report identifies a lack of system/controls in the firm.
>
> Last year, these s.166 requests focused on: Client Money, Corporate Governance, Past Business Reviews, TCF, Systems and Controls, Capital Adequacy, Regulatory Reporting and Market Abuse.
>
> The FSA is not obliged to use this route, but can instead ask firms directly for the same information under s.165 without using a "skilled person".

Cost

We were provided with less detail about s.166 costs. All of the reported s.166 requests were said to have been undertaken for supervisory purposes, with an aim to assess risk and governance functions. Nevertheless, the total cost of a s.166 procedure per firm was at least £300,000 and in two cases amounted to £1,000,000–£2,000,000, driven up by external costs. Internal costs, where reported, amounted to a total of £100,000–£500,000 and reflected in one case around 500 hours (equivalent to 63 person days) of senior management and other staff time.

Further comments

We understand that two or three years ago, there were only a handful of skilled persons' reports across the financial services industry, but anecdotally the number of s.166 reports has been increasing. It is unclear whether this results from a genuine decline in the controls of firms or a concern by FSA that firms have issues with their systems and controls.

Respondents expressed concern about the frequency and rationale behind the application of s.166 reporting, especially where it was used for general supervision and information gathering, rather than to address a specific problem. In particular, it was felt that the application of s.166 to investigate areas of supervisory uncertainty was less rigorous than would be desirable and undertaken in areas in which the FSA could be expected to possess sufficient internal expertise:

> *"While I can appreciate the need for a s.166 in particularly serious cases, or technical areas where the FSA does not have the technical expertise in house, as I understand it, a large number of the s.166s have been on general governance. This is an area where the FSA should be more than capable of forming an opinion based on their more intrusive and detailed ARROW assessments. This would save time, cost and a great deal of effort and I would expect them to have people within the FSA who are capable of making these assessments."*

Another concern was the frequent use of s.166 in cases where alternative ways of regulatory supervision could reasonably be employed:

> *"It is […] disproportionate for [the FSA] to seek to use s.166 where it would be sufficient to require the firm to engage 3rd party support either to investigate or validate their internal investigation—both far less expensive options."*

A particular criticism of the s.166 process was the risk of driving up cost because firms could not exercise control over charges when dealing with external providers:

> *"There is a significant risk that because the normal disciplines of commercial negotiation are removed or significantly diminished in the context of a s.166 exercise, which typically cannot be precisely scoped at outset, there is often no effective control on the fees charged by the major providers of such reports."*

Additionally of course, such costs are hard to provide for accurately in the usual budgetary process.

3. *Comments on other aspects of the regulatory process*

Cost connected with the Internal Capital Adequacy Assessment Process (ICAAP)

In addition to ARROW and s.166, respondents also reported the cost of other aspects of regulation. The ICAAP (including all aspects of the capital-setting process) has been the target of some criticism, with regulatory fees in some cases in the region of £1,000,000 and increased capital requirements putting significant strain on investment management business models:

> *"The requirement to hold increased capital (especially for investment management businesses) creates a drag on the business, restricting business investment and lowering profitability. The increases demanded in the Individual Capital Guidance (ICG) are not open to scrutiny and appear arbitrary. [An as yet unpublished industry survey is said to] indicate that the ICG figures are being raised on average to c.175% [of the Pillar 1 amount which is itself broadly three months fixed overhead requirements]. At this level, surplus capital for the asset management business almost disappears and additional capital will need to be set aside."*

> *"It is sometimes difficult to understand the focus applied by the FSA where a generic approach to supervision has been applied without necessarily considering the specific circumstances of the firm. Although regulatory capital and liquidity are important aspects of financial and operational stability, where there is ample surplus and/or significant liquidity, it is not always apparent why the FSA's focus on technical fine tuning of these individual requirements is an appropriate use of management or the FSA's time."*

> *"We have experienced an unwillingness/inability to embrace an appropriate regulatory capital regime for us. We hold a strong view that FSA have pursued a disproportionate approach to assessing the capital requirements for asset management firms that fails to reflect their risk profiles—200% to 400% ICGs [are said to be] not unusual and not supported by historic data. This leads to significant cost of capital being incurred."*

Another respondent complained about the lack of transparency in relation to capital uplift and that references by the FSA to their peers holding more capital for certain risks seemed in their view to defeat the process of performing detailed company-specific analysis in-house.

The quality of supervision

A number of respondents were critical about the quality of supervision, reporting an "increase in intensity/depth of supervision allied with a decrease in the overall expertise and/or experience of day-to-day supervisors", which was attributed to high turnover of FSA supervisory staff. This, in turn, also reportedly increased the cost to firms of re-educating and training new FSA teams on particular areas of focus. Furthermore, instead of close supervision functioning as a two-way exchange process, it was perceived as merely another type of information channel to the FSA without much feedback or exchange of market/regulatory intelligence.

> *"In our opinion the FSA should concentrate on hiring sufficient numbers of competent individuals with relevant industry experience and who understand the practical issues surrounding asset management which will in turn result in an enhanced service to member firms and will reduce the amount of reliance placed on box-ticking exercises."*

Separately from this survey, we are aware of reports from one or two other firms that the quality of recent visits has improved.

Conclusion

IMA hopes this paper will be the start of a more detailed debate on cost. ARROW visits and s.166 reports are activities which are justifiable in fact, but may be disproportionate in application. Furthermore, they are activities of the regulator which, unlike rule-making, are not subject to CBA or other impact analysis. Indeed these activities are, we suggest, subject to little direct constraint under legislation. The need for the FSA to use its own resources "in the most efficient and economic way" (section 2(3)(a) FSMA) might perversely tend to increase the usage of s.166 reports. If the nature of supervisory costs is that they cannot be subject to legislative constraints (analogous to CBA), it is even more important that the Committee is aware of the size and impact of costs; costs which we believe will fundamentally in a competitive environment always pass back to the investors and savers on whose ultimate behalf our firms manage assets.

October 2011

Written evidence submitted by Terence P O'Halloran

Compliance Costs

Thank you very much for requesting details of our costs in respect of regulation. The cost of regulation in part is passed on to our clients by way of increased fees. Much of it is passed on to the Partners in the firm in decreased earnings.

We are one of the few firms in the country that keep accurate time logs for all of our clients and the staff activity that corresponds; therefore our figures are accurate. From our analysis you might be interested to know that two thirds of our client accounts are in debit balance on a rolling basis. In other words two thirds of our clients never pay in full for the service that they receive. Our retainer is based on a fixed monthly figure. One cannot ask for more than a client is willing to pay.

We have assessed three years, which are our financial years, running from January to December, 2011. Partner's time will obviously be two months short of a total. PI insurance has been forced to increase in cost because of the activities of regulators and therefore is included as a regulatory cost. David Kenmir (the regulator manager 2002 onwards) coerced PI insurers into the position of public compensation funds. Our annual PI cover moved from £4,500 per year to £26,000 per year within a twelve month period. Fortunately, as you can see from the figures below, that figure moderated some four years ago to its current approximate £12,000 per annum (£1,000 per month).

I hope that you find that the figures are useful to you and, more importantly, that they help you to ascertain that the cost of compliance well exceeds the benefits delivered to the consumer.

O'Halloran & Co *The financial cost of Regulation* *for the years*	*2009*	*hours*	*2010*	*hours*	*2011*	*hours*
Professional Indemnity Insurance	11,954.00		12,218.00		11,167.00	
FSA fees and dues	3,345.00		2,227.00		2,065.00	
FOS dues	230.00		245.00		255.00	
FSCS dues	1,245.00		3,022.00		7,592.00	
Partners/staff time (from time sheets)	11,163.90	59.7	11,276.10	60.3	7,704.40	41.2
external compliance consultants	2,800.00		3,000.00		3,000.00	
Total cost of compliance	**£30,737.90**		**£31,988.10**		**£31,783.40**	
Total expenditure for the firm	**£379,801.90**		**£352,407.10**		**£348,982.40**	
compliance as a percentage of total costs	**8.09%**		**9.08%**		**9.11%**	

October 2011

Written evidence submitted by The Share Centre Ltd

Thank you for your speech to the APCIMS conference last Tuesday, 11 October. You encouraged us to write swiftly with comments on the approach to the Financial Conduct Authority, and I am taking that opportunity. My comments are brief in order to be able to respond in a timely manner:

1. Accountability

The fact that the FSA has been "above the law" has been a major problem, not simply in specific instances but in steering the culture of the organisation. In evolutionary terms it has become "a species without a predator" and has therefore become distorted and bloated in a way that mirrors any life form that has no challenge.

It is therefore very important that the Financial Conduct Authority should be open to challenge in British courts, even if the extent of damages is limited. This should include policy, supervision and discipline matters. For example it should be unacceptable for the FCA to drive enterprises out of business unless it can be demonstrated in court that this is in the public interest. Likewise defamation of character and impoverishment as a result of naming, shaming and fining individuals or businesses should be open to challenge and appeal as it is in any other walk of life.

2. Unreasonable focus on retail investment

It is hard to understand why the bias towards over regulation is so heavy in retail investment as compared to consumer credit and gambling. The suitability rules require that if an investment product is deemed to be unsuitable for the customer, the supplying firm must make good. Why does this not apply to bank lending? Or gambling? It would appear that regulation has been driven by what sells newspapers and curries the electorate's favour rather than by a sense of ethics or fairness.

We would like to see a better sense of proportion in dealing with retail investment, where the scale of commitment is often much lower than buying a car or a house, and yet regulation in those areas is comparatively light.

3. Costs

There is no doubt that the burden of financial regulation has weighed very heavily on the retail investment industry, to the extent that it is resulting in disproportionate costs which are inevitably carried by personal investors. Clearly it is not all FSA sourced regulation: money laundering also imposes a heavy weight, particularly for smaller transactions whose size is commonplace in non-regulated industries without burden.

The Share Centre has annual revenues of c. £15 million and a customer base of c. 225,000 investors. Average account size is c. £7,000. We estimate our annual FSA-linked costs as follows:

FSA/FOS Fees	£173,000
Compliance Department	£406,000
Regulatory Training	£30,000
Management Involvement	£200,000
Other Processes	£100,000
Total	£909,000

4. Attitude & Assistance

Unfortunately the move from self regulation to state regulation has changed the atmosphere from one of assistance to encourage best practise to one of "guilty until proved innocent". This inevitably distances investment firms from regulators, such that it is no longer possible to pick up a telephone and ask for guidance. A whole industry has been set up to second guess the regulator, which introduces a multiplier on those directly employed by the FSA (this alone now stands at over 3,300 (Aug 2010)—an increase of 20% over four years). We hope an element of the self regulatory culture can be reintroduced into FCA.

5. Financial Education

If we have better educated consumers we will need less regulation. In this respect it is unfortunate that the resources available for financial education for young people have been so severely cut. It is in the interest of the financial services industry to see a small mandatory levy—probably totalling no more than £10 million p.a., so that caveat emptor can reasonably resume its place in our industry.

6. Further consultation

We welcome the opportunity to submit comment at this stage, and hope it will remain a feature of the proposals as they develop.

October 2011

Written evidence submitted by Doug Brodie, Master Adviser

I am heartened by your words on the matter of regulation, and have attached our specific costs of regulation. These are direct costs and have no allowance for professional development costs, such as preparation for RDR, which we would regard as professional development.

I hope you are able to promote the message that the current regulation from the FSA produces compliant advice, not competent advice.

This is why the 'good advice' bombshells keep exploding in our banks; they are very good driving box-ticking through multiple layers of management, but good individual advice is consumer specific and needs a competent, trained adviser. We have previously suggested that advisers should be seconded to the FSA to support business monitoring—we can 'read' an adviser's business in no time at all, and identify likely problem areas through years of experience.

If of use, I have extensive management information and technical competence in the firm to supply further data or information. I can also normally corral other competent firms in this area.

October 2011

REGULATORY COSTS PER ANNUM

	DIRECT					INDIRECT					TOTAL
	FSA Fees	*FSCS*	*PI*	*FOS*	*sub total*	*Compl. Officer*	*Consultant*	*Compl. Support*	*Accts*	*sub total*	
Regulatory costs	£9,568	£10,856	£8,014	£796	**£29,233**	£26,682	£1,500	£3,540	£1,090	**£32,812**	£62,045
Cost Per Adviser (eight advisers)	£1,196	£1,357	£1,002	£99	**£3,654**	£3,335	£188	£443	£136	**£4,101**	£7,756
Cost Per case (1,015 cases in 2010)	£9	£11	£8	£1	**£29**	£26	£1	£3	£1	**£32**	£61
Cost per client (2,100 active clients)	£5	£5	£4	£0.38	**£14**	£13	£1	£2	£1	**£16**	£30

		Reg costs as %
Admin costs per annum*	£495,648	7%
Turnover 2010	£1,315,017	2%

Written evidence submitted by Simon Webster, Facts and Figures: Chartered Financial Planners

MACRO

Historic

Financial Services became regulated in 1988; since then the UK has lost c 400,000 life and pensions financial services jobs; including the destruction of many major financial services businesses such as The Prudential who used to have c 1,000 agents on the road and Sun Life of Canada who had another 1,000—a company I personally worked-for for 12 years.

SLOC still makes money in N. America and the far East but it cannot make money in the UK because the regulatory costs are so high. The question for those who establish the regulatory framework is: "is this a price worth paying for a well regulated UK system?" It might be if regulation had actually worked; but in the words of one of the early RDR discussion papers *"20 years of regulation have not brought about the desired results"*.

We now have RDR but we have already made the UK so regulated that few can afford to do business here. It also means that there are 400,000 less people involved in providing financial advice and helping people save money and protect their families. Clearly some were poor and effective regulation was required; but we have not had it and the attrition rate has been excessive.

Only recently Barclays pulled the plug on its K FS arm because it could not make any money out of it—due primarily to regulatory costs. While on one level few will shed tears over a bank in trouble, their captive client base should have given them an unassailable position but they could not make any money, so the UK loses yet more distribution.

It is worth underlining that those who do not by life and health insurance from the private sector will ultimately claim in the state at taxpayer expense.

Current

RDR demands higher qualifications this is no doubt a good thing but there are financial advisers with unblemished 20 plus years career who are being forced to go back to school and take complex exams. The absence of any grandfathering has put a huge and unnecessary cost on industry practitioners. In addition the FSA now requires advisers to be issued with a statement of professional standing *annually.* Another huge paper chase for what value? Those authorised to issue such certificates will doubtless make money.

The exact cost of qualification is hard to quantify (I had mine 10 years ago) but two or three months of exam study at say £150 per hour £6,000 plus the cost of the exams and study material, say £1,500 plus any courses another £500.

The cost of annual accreditation is as yet unknown as the requirements of those issuing the certificates are as yet unknown—but another couple of hours to collate the support data undoubtedly required so say £400 plus the certificate cost itself…

Capital Adequacy: The FSA has delayed the doubling of its capital adequacy requirements which means that firms have another couple of years to double the amount of dead money they are required to keep on their balance sheets. But there is an express cost to this one £10,000 in addition to the £10,000 we are already required to keep on deposit. The FSA claim that this proves that firms have enough money to meet their obligations. But it is a circular argument. If a firm uses the money to meet its obligations it is in breach. So it just becomes dead money. No other profession in the country has this ludicrous requirement. £10,000 plus another £10,000.

Liability

Caveat emptor has disappeared in financial services. If a client loses money their first thought is how can I get it back and the FSA has spawned a huge compensation culture where honest financial advisers are regularly having claims upheld against them on very tenuous grounds., Advisers also have open ended liability with no long stop… The excess on a claim is usually £5,000, but the cost of annual PI premiums is far higher than it should be due to the open ended nature of the liability.

MICRO LEVEL COSTS

In 1988 FS was straight forward—adviser were either tied agents or independent. The law of agency was clear: tied agents worked for their employers, typically banks or life companies, while independents worked on behalf of their clients. At the last rule rewrite c 2002—multi-tied advisers were introduced, they were neither one thing nor the other, although most multi-tied agents have consistently masqueraded themselves as independent—something the regulator has not done anything about, perhaps until now.

Now they want advisers to be independent or "restricted" so we are back to where we started but there remains, even at this late stage, considerable confusion in the profession about what is actually required of an independent firm. We now have a only year to decide how we are to trade, but we still do not know the rules. Of course for nearly 20 years we have proudly proclaimed ourselves as independent—it is the one thing most customers seem to want. But I am still not certain of the specific requirements and they have changed several times in the last 24 months.

I have personally attended three and a half days of training on this one issue alone in the last two months. I charge £200 per hour so the cost to my firm is 3.5 times eight times 200 which equals £5,600. It might all be worthwhile if I now knew the answer—but I don't. I attended one 3rd party course with other advisers who had also been to FSA RDR road shows where it became clear that different FSA teams were putting out conflicting information on this vital issue.

The Platform Debate

The FSA has determined that consumers should know the precise cost of every aspect of any financial transaction in cash terms. Like much of the what the FSA comes up with it sounds great in theory. But when people buy a car they do not know who much the engine or the seats cost individually—they just know that the car costs say £15,000. The FSA wants costs broken down to the nth degree. The cost of the paperwork to present this information is onerous in the extreme. The amount of paperwork the public is expected to read is excessive (often over 50 sides of A4 paper for a single transaction) and when there is a complaint the common client answer is: "I signed what I was asked to sign—but I did not understand it." In these circumstances FOS often deems the adviser liable.

Instead of an adviser being able to suggest invest your money with XYZ and the total cost will be x% per annum. The FSA wants advisers to break down the cost of advice, the cost of the platform, the cost of individual funds, dealing charges & stamp duty costs then add back the value of any rebate. In theory this is not a problem, but because the same funds are sold through many different outlets the fund management houses risk having to create whole rafts of different versions of the same fund with a different underlying charge (and therefore different performance) instead of having one fund and offering different rebates.

This is a subtle point but the cost ramifications are potentially exorbitant. So much so that when the FSA finally realised the scale of the problem it postponed making its rules in this vital area until after RDR implementation. So now as a firm we are not sure to best structure ourselves for the best. It is actually a farce. The cost to the fund management industry of these changes is incalculable but will run into many millions. There is also a huge cost to our firm alone which will run into thousands.

Adviser Remuneration

The FSA has determined that commission on investment business is bad because they say advisers are churning (rewriting) existing client plans to generate more income. The FSA commissioned research in this area which proved the contrary; but the FSA pressed ahead with a commission ban anyway. Instead of limiting the maximum commission that could be paid (which was deemed anti-competitive) we now have a move to what is being termed "adviser charging". Laughably this can be a percentage of the sum invested and can be taken from the product so in many minds it is still commission. BUT there are two huge unintended consequences of this route:

- There will be no commission on regular savings plans; so if someone comes into my office for advice on his £250 per month personal pension I have to charge him £500 up front to cover my costs. But it is generally accepted that most will not pay. Perhaps the FSA hopes people will deal online without advice (but where, as I understand it, commission can be paid). Consider the "success" of workplace stakeholder pensions—over 90% have zero contributions. Conversely individual stakeholder plans have a capped charge of 1.5% per annum and commission could be paid to advisers, while the no advice, and supposedly cheap NEST plan has a 1.8% contribution charge and a 0.3% AMC—which equates to a 1.5% per annum AMC. In other words commission based advice is available under present rules—effectively free. It's not, because zero commission stakeholders are available with a sub 1% AMC. But the question then becomes is advice and the motivation to invest worth 0.5% per annum–surely it is?
- In addition one bi product of adviser charging is that those clients with investment bonds in receipt of on-going advice will have to fund that advice from their 5% annual withdrawal allowance rather than from the product so those who qualify for age allowance are now being disadvantaged.

Every advice firm in the UK is having to rejig its business model to comply with adviser charging. Commission is being banned to solve a problem that does not exist at a huge cost to every advice firm—we have spent literally weeks on this—at least £30,000 worth of time. But the future of our business (and every other advice firm in the UK) is at stake.

At manufacturer level every product provider in the UK is having to rewrite their software yet again at the behest of the latest FSA whim. Let us not forget this is not the first "play" they have had with adviser remuneration: first they introduced mandatory c 8 page illustrations; then they mandated hard disclosure of commission and now this; and each change requires yet more hugely costly IT work from every product provider in the UK.

C 4 years ago when RDR was first floated and the FSA's interest in abolishing commission on investment business became known they were warned that EU rules (now crystallised as MIFID 2) might have a serious impact here. Nevertheless they were determined to proceed. We are about to enter RDR and only a month or so ago the MIFID rules, which are potentially binding on the UK were published and they are totally at odds with what the FSA is trying to achieve. So this area is again a mass of confusion. All at huge cost.

October 2011

Written evidence submitted by Ruffer LLP

1. *Executive Summary*

1.1 Ruffer LLP welcomes a number of proposals in the FCA paper, especially those relating to a commitment to retain the regulatory principles concerning proportionality and transparency.

1.2 We consider that the FCA's approach to regulation should ensure that:

- Policies and rules reflect a sound understanding of the different types of firms in the financial services industry;
- It properly balances the interests of the consumer and the provider so as to achieve a robust and well regulated industry;
- It is able to attract and retain high calibre staff with sufficient understanding of the different industry sectors;
- It increases its focus on effective supervision strategies in order to achieve a better balance between its roles as regulator and supervisor;
- There is adequate and transparent accountability for the way in which the FCA discharges its responsibilities;
- The interaction with international regulators is robust and sufficient enough to impact policies at the formulation stage thereby protecting the interests of UK firms and consumers; and
- It ensures that the UK remains a competitive jurisdiction for financial services firms to set up and grow their businesses, for the benefit of the UK and EU economies.

2. *Introduction*

2.1 Ruffer LLP is an FSA regulated discretionary investment management firm with assets under management of over £12 billion. The firm will be solely managed by the FCA under the new UK regulatory structure. Ruffer is also a member of APCIMS.[53]

2.2 We support APCIMS' submission to the Treasury Committee's inquiry into the FCA dated 10 October 2011, including the views expressed in support of certain aspects of the proposed approach and those raising some concerns. However, we are particularly concerned about some specific aspects which we consider need highlighting further.

3. *Does FCA's approach represent improvement?*

3.1 Whilst it is too early to draw any conclusions on the efficacy of the FCA's approach, we support the retention of regulatory principles concerning proportionality and transparency. However, we think that these principles could be used in a more effective way, with beneficial outcomes.

3.2 The effective application of the principle of proportionality depends to a large degree on the level of understanding that the FCA has of the market and its participants. A thorough understanding of the different services offered by the different types of firms in the investment/wealth management sector (for example, discretionary managers, advisory managers, execution only managers, financial advisers, brokers) and the differences between the way small and large firms operate is essential. Better insight will ensure rules and regulatory guidance are more relevant for regulated firms and therefore easier to apply in a meaningful and effective manner.

3.3 The use of a tiered regulatory approach in the application of the Remuneration Code is an example of how a good level of understanding can be, and has been, used to provide proportionate regulations. This was achieved by paying close attention to the industry and sufficiently engaging with them during the consultation stage. The FCA should consider using a tiered approach more widely when formulating regulatory policies, particularly where its intelligence points to the fact that a one size fits all approach for the industry will not be suitable.

3.4 We do not consider that "consumer protection" should be the key principle of the FCA. As the FCA is a public body regulator, its job is to properly balance the interests of the consumer and the provider so as to achieve a robust and well regulated industry. The right level of intelligence can be achieved by fostering industry focused groups who act as "industry champions"; and we anticipate that the FCA will seek input from those groups who represent consumer interests.

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[53] The Association of Private Client Investment Managers and Stockbrokers (APCIMS) is a trade association representing private client investment managers and stockbrokers as well as associate members who provide related services to member firms.

3.5 To improve the standing of the FCA, it is also essential that it is able to attract and retain high calibre staff with sufficient understanding of the different industry sectors. This would lead to firms having greater confidence in the ability of the supervisors to understand their businesses and therefore regulate them more effectively. Understandably, it may not be possible for the regulator to match the remuneration offered by financial services firms in the City. However, the FCA should aim to strike the right balance and to do its best to attract and retain suitable personnel.

3.6 The regulatory approach can be improved further if the FCA adopted a strategy aimed at achieving more effective supervision within the existing regulatory framework, rather than seeking to use more regulation to address existing issues. The Financial Services Authority may have been guilty of this in the past, whereby it channelled its resources towards devising new policies, whilst escalating its use of skilled persons reports ("Section 166") as a way of bridging gaps within supervision. The Financial Services Authority currently regulates to a large extent by issuing more rules and punishing firms and approved persons for non-compliance. Working more closely with firms to achieve the desired objectives would be welcomed by the industry and be a more effective approach to supervision.

4. *To whom should the FCA be accountable? Are the lines of accountability clear?*

4.1 We support the proposals dealing with the governance and accountability of the FCA, especially the requirement to report to HM Treasury. There is a feeling in the industry that the Financial Services Authority lacks accountability, so HM Treasury must ensure that steps are taken to address this. It has to be seen to provide adequate oversight and challenge to the FCA where necessary.

4.2 One of the areas where increased accountability would be welcomed is policy making. Increased scrutiny of regulatory consultations by HM Treasury is desirable. The FCA should be required to provide satisfactory logic as to their reasons for deciding to press on with rule changes where there is a strong difference in opinion between the regulator and a significant section of the industry regarding the validity of proposed rules. In such circumstances, HM Treasury should independently review the proposed policies in order to ascertain whether there is credible evidence from the industry that such rules have not been thought through properly, leading to either practical difficulties with meeting the proposed regulatory obligations or not achieving the FCA's desired effect.

4.3 Furthermore, if points raised by the industry during the consultation process are not factored into rules because they were not deemed relevant at the time, the FCA should listen to post implementation feedback to assess how successful regulatory initiatives have proved to be and, on identifying the resulting problems, address the issues swiftly.

4.4 There should also be clear terms of reference and key performance indicators that can be used to assess whether the FCA is meeting its obligations and operating within its boundaries, especially as it will have more intrusive powers. It will be more difficult for the FCA to be held accountable for its actions if market participants and indeed the FCA itself are not clear about its remit.

5. *How should the FCA be interacting with international regulators? Do EU regulation initiatives restrict or enhance the work of the FCA? Will the FCA be able effectively to engage with the EU supervisory authorities?*

5.1 We expect the FCA to engage actively with the EU authorities in an effective way, as well as with all other relevant international regulators. Under the new EU regime, rules will increasingly be made at EU level and local regulators will not have the power to alter these. The EU authorities have made it quite clear recently that its new approach to regulation will be to seek maximum harmonisation, but in the wealth/investment management industry the starting point is one where consumers' product preferences and industry distribution structures vary enormously across member states. This emphasises the need for the FCA to negotiate vigorously with the EU at the early stages of any new initiatives or proposed rule changes in order to maximise the chances that these will be properly aligned with the interests of UK firms and their customers. In addition, it is extremely important that the FCA liaise with the other tripartite authorities in the UK to ensure that the UK financial regulators speak with one voice in Europe.

5.2 The FSA already actively engages with the EU and other international regulators, with varying degrees of success achieved in representing the UK's interests. Whilst a 100 percent success rate is unrealistic, the FCA should continue to interact with international regulators to improve the UK's bargaining position as it will be even more important in future.

5.3 However, a lot of the regulatory burden currently placed on UK firms has not been purely as a result of EU initiatives, but rather, from the FSA going over and above EU requirements. The FCA, in conjunction with HM Treasury, should adopt a policy of not seeking to gold-plate EU law unless EU law is evidently deficient.

5.4 In addition, the FCA should actively consider the impact of proposed policies on the attractiveness of the UK market place. The investment management of UK institutional and retail assets remains, today, predominantly in the UK. The industry, including our own business, has additionally shown considerable success in attracting assets from overseas institutions and individuals to be managed by UK firms. This has created a healthy industry, as well as significant employment and contribution to UK economic growth.

However, it is an international industry, with virtually no physical barriers to entry. Policies which hinder the UK's competitive position would create such a barrier within the UK and should not be pursued unless they are appropriate. Policies which are conducive to sound investment business in the UK can support the ongoing growth and contribution of this sector, in both the UK and the EU. The FCA will have an important role to play in determining the future direction of the industry.

October 2011

Written evidence submitted by Adviser Alliance

There are many fundamental problems within financial services and the TSC has been made aware that the FSA is the cause of many of these problems. When Hector Sants and Sheila Nicoll appeared before the TSC to explain and justify the planned RDR changes they made it clear that they could and would do whatever they wanted regardless of the TSC's views and recommendations. The inability of any individual or body to shift them from potentially catastrophic changes highlighted the parlous situation where Parliament has enabled a public body to set up as an unaccountable Star Chamber.

Are the objectives of the Financial Conduct Authority (FCA) clear and appropriate?

Not as clear as they need to be. Whilst one stated intention is to provide consumers with an appropriate degree of protection**,** it is vital that the FCA also has objectives of promoting both competition and confidence in the financial system. Looking at the FSA's historic actions it can be seen that its public utterances often cause a lack of confidence amongst consumers. Its poor oversight in respect of Equitable Life, Northern Rock and HBOS served to reinforce the view of it being an ineffectual and costly quango. Its refusal to publish the result of its enquiry into RBS confirmed its disdain for consumers and Parliament.

In the headlong rush to advance the mooted RDR changes it has continually commented in speeches and press releases about endemic mis-selling and consumer detriment. Such comments then find their way into the media and this does nothing to boost the industry or its competitiveness, instead it deters consumers from engaging and causes them to defer or completely ignore financial planning.

There are numerous systemic problems within the industry and with regulation, and the FSA, rather than solving them, has actually become one of the problems. The FCA has an opportunity to distance itself from the many mistakes of the FSA and to operate as a fair and reasonable body.

It is imperative that the FCA abides by the Human Rights Act and is not allowed to dismiss the valid and reasoned arguments of legal experts and regulated firms with regard to the human rights of regulated firms that have previously been removed by drafting of the rulebook.

Should the FCA have a primary duty to promote competition as recommended by the Treasury Select Committee and Independent Commission on Banking? How should this work in practice?

Increased competition is to the ultimate advantage of consumers. Perforce, any unnecessary regulatory intrusion will diminish competition. This has already been evidenced by numerous firms opting to leave the market due to the imminent RDR changes (Co-operative Financial Services and Barclays Bank being two such examples).

The promotion of competition requires understanding of retail financial services, an understanding which thus far has eluded the FSA. Competition works to the advantage of the consumer but only where firms have sufficient confidence in its future to invest time and capital in providing a service.

Does the FCA's approach to regulation, as outlined in the Financial Services Authority (FSA)'s June 2011 document, represent an improvement on that of the FSA?

One is tempted to ask, could it be any worse. However the reality is that with even greater powers, there is the potential for an non-elected, non-accountable quango buoyed by open-ended funding descending on the industry with a vengeance. With little in the way of a robust appeals process the prospect is unthinkable.

To whom should the FCA be accountable? Are the lines of accountability clear?

The issue of accountability is of overriding importance. The TSC has already seen prima facie evidence of the FSA's lack of accountability which leaves them immune from any interference even when they embark on foolish initiatives which affect the livelihood of practitioners and consumers**'** access to financial services.

This lesson must be heeded. The FCA must be accountable to Parliament so that the TSC and ministers are able to intervene when the regulator**'**s exuberance overwhelms balance and commonsense.

It is suggested in some quarters that, by providing an annual report to the Treasury, the FCA is somehow accountable. This is not the case and to ensure that it is not able to proceed with foolish, dangerous and possibly ultra vires actions there must be some robust framework to ensure balance and true accountability.

Better still, the FCA should be a division of the Treasury where it will fall within the remit of Parliament and the Parliamentary Ombudsman.

The FSA has an immunity from legal action with the exception of actions in bad faith or in breach of Human Rights. This has enabled it to disregard the industry and the TSC with impunity. Surely this was a monstrous mistake and must not be repeated with the FCA. Absolute power corrupts absolutely and the current suggested design of the FCA must be leavened by commonsense and balance.

Are the powers of the FCA suitable? Will their exercise be subject to appropriate scrutiny? How should the FCA be interacting with industry as well as using its intervention powers?

Since the imposition of the FSA the industry has laboured under an "us and them" situation. All practitioners complain that the FSA refuses to listen to their genuine grievances. Consultations are seen as a sham where a due process is followed which then results in an identical result to that originally suggested. The remit of the Independent Complaints Commissioners is too limited which reduces the abilities of the regulated to formalise a complaint and enjoy the benefit of an independent review.

The RDR experiment has shown up the process of industry consultation as a sham. The reality is that the regulator outlines its plans, asks for responses and then explains in a policy statement that it will do exactly as it originally intended. Some form of oversight and appeal must be introduced to avoid the excessive powers invested in the executive being mis-used, as is currently the situation.

The FSA has vast powers at its disposal but the application of these has been haphazard and often dilatory. Whilst complaining about mi-selling and consumer detriment it waited eight years before dealing with PPI mi-selling. This practice, perpetuated primarily by the banks, had been highlighted by advisers and journalists many years before the FSA deigned to act. In waiting this long the problem was magnified leaving many to believe it a purposeful delay which served it well in pushing for reform and introducing its RDR experiment.

How will the break-up of the FSA work in practice? Issues of coordination and information sharing between the FCA and the Prudential Regulation Authority (PRA)

As the head of the FCA will sit on the board of the FCA it seems that a sharing of knowledge will take place.

How should the FCA be interacting with other domestic regulators? For example, the FCA's relationship with the Bank of England and Financial Ombudsman Service

The FOS is seen as a creature of the FSA. This is not surprising seeing as the FSA was responsible for setting out the Dispute Resolution Rules which defined the FOS's terms of reference and the obligations of regulated firms.

The FOS works outside of English Law and this provides for an imbalance in the relationship between consumers and regulated firms. FOS decisions are binding on firms with the financial limit for awards due to rise to £150,000 per upheld complaint. Personal hearings are rarely allowed (around 20 p.a.) even though the then Treasury economic secretary guaranteed this when FSMA 2000 was at its committee stages. To add to the imbalance, an independent appeal system is denied firms with all "appeals" being dealt with internally by an Ombudsman.

Previous Chief Ombudsman, Walter Merricks, likened the process to one side playing uphill and, in the pursuit of "natural justice", it is patent that regulated firms are continually denied justice. FOS has boasted that it makes "new law" and this recognition of its quasi-judicial powers makes a mockery of the law and the rights of regulated firms and individuals.

Whilst all UK businesses and individuals operate within "normal law" and enjoy the basic protection and human rights that this affords, the financial services industry labours within a quasi-legal quagmire where the FSA is able to ignore statute and put in place whatever rule changes it feels appropriate, regardless of whether they conflict with English law or infringe Human Rights. It does so whilst waving the flag of consumer protection, a convenience provided by its statutory obligations but, nonetheless, one that should not be countenanced or allowed to continue under the FCA regime.

Laws that have evolved over the years and been ratified by Parliament after due debate, as well as precedential judgements by the courts, should not be discarded by a non-accountable regulator without some form of non-judicial recourse.

There are clear examples of this wanton use of non-accountable powers. The summary removal of the 15 year longstop provided by the FSA's drafting of the Dispute Resolution rules is the most obvious example. Another is the re-writing of the "three year rule" in respect of complaints about endowment mortgage plans.

When considering the limitations and remit of the FCA one must also consider the parameters and working practices of the FOS to ensure that fairness and balance form a natural accompaniment to financial regulation. It has been suggested that the FOS becomes part of the tribunal system under the auspices of the Ministry of Justice. We commend this proposal and believe that it would remove the current unfairness as well as providing an independent complaints system that both sides can respect.

Justice is not some capricious concept malleable at the behest of a regulator. The rule of law must be respected. The FCA cannot be enabled to continue the current imbalance by setting rules and regulations which defy the law and also remove the basic Human Rights of regulated firms.

How should the FCA be interacting with international regulators? Do EU regulation initiatives restrict or enhance the work of the FCA? Will the FCA be able effectively to engage with the EU supervisory authorities?

Practitioners have experienced the FSA playing both sides of the EU regulatory game. When the EU moots a potential directive, such as MIFID II, the FSA seeks a dispensation so that it can force through its RDR experiment. On other occasions it seeks to gold-plate EU regulations so that other of its plans can be delivered.

Either the FSA is independent of Europe or it fits in with the EU regulatory dictate—it cannot pick and choose those policies that suits its purposes. The FSA is not the "world class regulator" as suggested by Gordon Brown. Neither is it a fitting template for the FCA even though it will be populated by the very same functionaries who currently wear the FSA colours.

October 2011

Written evidence submitted by John Howard, former Chair of the Financial Services Consumer Panel and a former Non-executive Director of the Financial Ombudsman Service

The Financial Ombudsman and Regulation

1. At the heart of the ill fated court action by the banks over Payment Protection Insurance was a growing sense that the Ombudsman service was becoming a quasi regulator.

2. And the judge in the case accepted that the Ombudsman can go above and beyond the FSA rules. Mr Justice Ouseley said in his judgement[54] that the FOS could hold that a firm should pay compensation even though (the firm) had complied with the specific rules.

3. This endorses the findings of the Court of Appeal in the case of *Heather Moor & Edgecomb Ltd v FOS*,[55] that the Ombudsman was not bound by the common law and could exercise his own judgement as to what was fair and reasonable.

4. This has created uncertainty in the financial services industry, which means additional risks for firms, which create more costs that must eventually be paid by customers.

5. I think that the uncertainty is misplaced and firms can be much more confident about the products they sell and the advice processes they use but they will need to change their approach to deciding what is fair to customers.

Background to the Ombudsman's Powers

6. Just about all consumer legislation seeks to do one thing; to even up the negotiating positions of buyers and sellers. This is true in financial services as well. Most financial regulation has been put in place to try to overcome the knowledge asymmetry that exists between buyers and sellers of financial products. The seller knows all there is to know about the product, the buyer knows very little, apart from the advertising hype and, if they have read and understood them, the restrictions and conditions in the contract.

7. If a customer understands all there is to know about a product and purchases it willingly (without coercion or deceit) then the sale must be "fair" and the customer must stand by their decision to purchase.

8. The retail regulations put in place by the regulator are requirements to provide certain information, and present it in a particular way, to aid the customer's understanding. The rules are the regulators attempt to ensure the customer understands what they are buying.

9. Successive layers of regulation set out what can and cannot be said in adverts; what must be explained in key documents; what the sales person should tell the customer, all in an effort to help the customer understand the product.

10. But even the best rules cannot ensure understanding. Instead regulators use the provision of information as a proxy for understanding. If the customer was given the required information about the product in the right form, the regulator presumes the customer understood what they were buying.

11. If a firm has not stuck to the "rules" there is, in effect, a presumption that the consumer did not fully understand what they were buying and that the transaction was therefore unfair.

12. If a complainant goes to the FOS, and the firm has not fulfilled the information requirements, the FOS is most likely to find against the firm and in favour of the consumer.

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[54] R(BBA) v FSA and FOS[2011] EWHC 999 (Admin) at para183
[55] (Heather Moor & Edgecomb Ltd) v FOS [2008] EWCA Civ 642, [2008] Bus LR 1486.)

13. But this simple approach fails to acknowledge the weakness in all regulation and law making. It is not possible to make rules that cover all possible circumstances. This is why the FOS has the power to fill in the gaps. It is required to take into account any rules and regulations in making its decisions but the overriding consideration of the FOS must be the much wider consideration of what is fair and reasonable.

14. The FSA Handbook sets out the FOS powers.

DISP 3.6.1

The *Ombudsman* will determine a *complaint* by reference to what is, in his opinion, fair and reasonable in all the circumstances of the case.

In considering what is fair and reasonable in all the circumstances of the case, the *Ombudsman* will take into account:

(1) relevant:

  (a) law and regulations;

  (b) regulators' rules, guidance and standards;

  (c) codes of practice; and

(2) (where appropriate) what he considers to have been good industry practice at the relevant time.

15. A firm may follow to the letter the regulations for the sale of a particular product but this cannot guarantee that a particular consumer, in their specific circumstances, has understood what they have bought.

16. I believe that this is the strength of the Ombudsman system. It is in this situation that the FOS has the power to ignore the law and the regulations and come to a decision that, in the particular circumstances of that case, the deal was unfair.

17. Fairness is a question of judgment and so the Ombudsman service is charged with making a judgement about whether the consumer understood what they were buying. If the Ombudsman's judgement is that they did not, he can then decide that the transaction was unfair despite what the rules say. This is a fundamental principle which must be preserved.

How Should the FOS Reach its Judgements?

18. In the simplest case, if the FOS finds that a product or process does not meet the FSA rules, it must find in favour of the customer.

19. If the firm or firms have sold the same product in the same way to many customers, the FOS will have identified a systemic problem. If, of their own volition, the firm or firms are not prepared to recompense all customers with similar cases, the FOS should not be placed in the position of hearing hundreds of similar cases. In those circumstances it should be *required* to notify the regulator. (This is a step beyond the "Wider Implications" process.)

20. The regulator is empowered to deal with systemic issues and it should be *required* to take up those cases and, using its enforcement powers for a breach of the rules, order compensation for the affected consumers and approve changes to the product or process before their continued sale.

21. If the product or process is fulfilling the regulator's requirements, then the FOS should still go on to ask a number of other questions.

First, "Did this *particular* consumer understand the product they were buying?".

If the customer did understand the product the FOS must find against the consumer, because he understood and accepted the risks.

22. If it believes that the consumer did not understand, it must then ask: "Given the circumstances of the case and the information and advice provided, *could* this particular consumer have understood the product if they had tried?".

If it concludes that it was unlikely that the consumer in question could have understood, it must decide that they were treated unfairly and find against the firm.

23. In that case the Ombudsman must then go on to ask: "Would a reasonable person involved in an identical transaction have understood what they were buying?".

If the Ombudsman concludes that a reasonable person would have understood the product there are no wider implications.

If the Ombudsman judges that a reasonable person would not have understood the product, it will again have identified a systemic problem which should be referred to the regulator.

Implications for the Financial Services Industry

24. This approach does require a major shift on the part of the financial services industry.[56]

The industry must recognise that retail regulation is the FSA's attempt to ensure that customers understand what they are buying. But inevitably simple adherence to the rules cannot guarantee that a customer understands.

25. The final decision on whether the customer understood what they have bought belongs to the Ombudsman in any individual case. This means it is not sufficient to simply comply with the rules. Firms must judge whether the Ombudsman will accept that the customer understood the deal.

26. When designing products and processes firms must ask, "would a reasonable consumer provided with this information, presented in this way, understand what they were buying?" If the firm can answer "yes" to this question it will avoid a systemic complaint.

27. If the firm then receives a complaint about that product it must again ask if that *particular* consumer understood what they were buying or could have understood if they had tried. This is the question the Ombudsman will ask.

28. Firms must ensure that each customer understands what they are buying and they must be prepared to live with the consequences if they do not succeed in conveying that understanding.

29. This will present a major challenge to the industry. It has always relied upon processes which treat customers en mass; solutions which *generally* produce a fair outcome for the majority of customers. This is probably no longer adequate. Firms must attempt to produce processes which will identify if individual consumers understand what they are buying.

30. It also raises a number of ethical questions which the FSA has said society must decide. The first is, should customers who do not understand a product be denied the opportunity of buying it? How much of a product and its associated risks should they understand? This could exclude sections of society from purchasing products of benefit to them. If they cannot understand the nature and risks of a mortgage should they be prevented from becoming home owners?

31. If they do purchase without understanding the product, they are relying on the seller to make paternalistic judgements on their behalf. The seller is obliged to ask himself, "If I was this person, but knowing what I do, would I buy this product?" and if the answer is no, not selling it to them. This debate will be the subject of another of my papers.

Disagreement Between FOS and FSA

32. When, in the circumstances above, the FOS notifies the regulator of a systemic unfairness, this could create a point of disagreement between the regulator and the ombudsman. The FOS may decide that a systemic issue is creating unfair outcomes for consumers and refer it to the regulator. The regulator may disagree and say, on balance, the product or process is not producing unfair outcomes for consumers.

33. Any MOU between the FCA and the FOS must therefore contain a mechanism whereby a decision on fairness about a systemic issue identified by the ombudsman and referred to the regulator, must be agreed by the regulator and the ombudsman. The FSA must have the final decision and the ombudsman must sign up to that interpretation.

34. Any subsequent departure from the agreed position on the point must only be allowed if any new case can be distinguished by the Ombudsman on its particular circumstances from the original point.

FOS Publishing it's Determinations

34. It is entirely appropriate that the FOS publishes details of the Ombudsman's determinations (but not adjudicators rulings) but it must be accepted that these are not precedents and will not be binding in future, because the Ombudsman is making a decision which relies on the particular circumstances of each individual case.

35. So the FOS should also explain whether it regards the decision as turning on the particular facts of that individual case or whether there are likely to be many similar cases. As described above, if the ombudsman believes there could be many similar cases then the FSA should be required to take regulatory action to deal with those cases.

36. The publication of details of cases have a number of advantages:

(a) This will widen understanding of the Ombudsman's view of fairness and his approach to particular types of cases.

(b) It will encourage confidence in the FOS because the industry will have a greater understanding of the FOS approach.

[56] R(BBA) v FSA and FOS[2011] EWHC 999 (Admin) at para183
R(Heather Moor & Edgecomb Ltd) v FOS [2008] EWCA Civ 642, [2008] Bus LR 1486.)

(c) It will encourage consistency of approach within the Ombudsman Service itself.

37. Case reports should be anonymised to protect members of the public and ensure that they are not discouraged from bringing their cases to the FOS.

Conclusion

38. The Ombudsman's discretion to ignore the law and FSA regulations and make a judgement based on what is "fair and reasonable" is central to the success of the service and should not be tampered with in any way.

39. Success in these terms is a speedy, uncomplicated, efficient and accessible dispute resolution service that is free to the public.

40. Purists may challenge the legal robustness of the process but to try and improve the service by making it more legalistic will defeat its purpose and do consumers and firms a disservice.

September 2011

Written evidence submitted by the Office of Fair Trading

Competition and Financial Regulation

I promised to set out to you the OFT's views on the interaction between competition and financial regulation in the context of the reforms proposed to the system of financial regulation and in particular the role and functions of the FCA and PRA.

In brief, the OFT believes that the FCA should have a "top line" objective to promote competition, ideally expressed in terms of making financial markets work well for their users. As an authority with a significant economic impact, the PRA should also be required to take account of the need to promote competition as part of its weighing up the costs and benefits of different regulatory approaches. However, the OFT also believes that giving the FCA certain "concurrent" competition powers (overlapping with its own) would risk weakening the competition regime. Instead, it recommends some pragmatic mechanisms to "lock in" a pro-competition approach in the work of the FCA.

On the first issue, I explained to the Treasury Select Committee on 20 January my view that the FCA should have a top line objective to promote competition. It is critical that the new FCA regards competition as a mechanism for achieving outcomes for consumers—and in that sense it should be clear that having such an objective does not conflict with the need for consumer protection. Making this explicit in the objectives of the FCA is one important element in making sure that this happens. It is important, for example, in ensuring that cost-benefit assessments of regulatory changes by the organisation can include the benefits of dynamic market change through competition, rather than simply the static benefits to an individual consumer of being protected. We note that our view on the importance of the competition objective is substantively shared by the Independent Commission on Banking and is consistent with the Treasury Committee's own report.

We see merit in framing such an objective in terms of contributing towards making financial markets work for the benefit of their users—whether retail or business users. Such a formula would make clear that competition is about achieving better outcomes for consumers and other users, and help ensure that the FCA will regulate in the interests of users and not market incumbents. We believe that an objective relating to confidence in financial markets is not the way to achieve these outcomes: it relegates competition to a potential contributing factor and one which may be seen as secondary to other factors. We would therefore recommend that the strategic objective of the FCA is changed to: "making financial markets work well for their customers" rather than generating confidence—"protecting and enhancing confidence in the UK financial system"—as currently phrased in section 18(2) of the draft legislation (concerning the FCA's general duties).

We also believe that the PRA should have regard to competition as it takes its regulatory decisions. Although its work is not so closely related to the conduct of markets as that of the FCA, its actions may have significant consequences for markets. A good example would be in the setting of capital requirements differently on competing types of activities or businesses: this would tend to have consequences for barriers to entry, and hence for competition in markets. It would seem reasonable for the PRA to have regard to such concerns, even if it has the ability to assess that the total economic benefits of such arrangements outweigh the competition worries; it would, for example, encourage the PRA where it has a choice of different regulatory approaches to achieve the same financial stability outcome to select the one with the least impact on competition.

On the second issue, we believe it is important that the ability of the OFT—or the future CMA—to use its competition tools in financial markets is not reduced or compromised by giving the FCA "concurrent" competition powers. The ability to review financial markets, including through its market studies and to make recommendations and references as appropriate through the procedures laid down in the Enterprise Act, is vital for the OFT as a national competition authority. Giving the FCA a formal "concurrent" remit alongside the OFT for making market investigation references to the CC would give us concern for many reasons including:

— The risks of inconsistent use of these tools across the competition regime which lead to greater uncertainty for business, and the likelihood of financial business pressing for “special treatment” within the competition regime;

— The need for the FCA to develop a skillset that the FSA currently does not possess around competition assessments—and the parallel risk of then creating a duplicative set of skills in different public authorities;

— The fragmentation of roles weakening the ability of the competition regime to support the Government in tackling strong vested interests and the usual problems of overlaps or, more likely, gaps in action;

— The risk, as with other sector regulators, that the tool is used by neither the FCA nor the OFT; and

— Partly as a result of these, the likely withdrawal by the OFT from working on the markets covered by the FCA leaving the “sectoral” body to conduct these activities. We see this risk as especially important. One specific consequence of this would be that external assessment of the impact of the FCA’s own rules on competition—despite their potential significance themselves as a barrier to market entry, for example—would be diminished. In short, would the FCA ever be capable of carrying out thorough independent analysis of its own rulebook from a competition perspective as part of a market study?

These concerns arise even more markedly with regard to anti-trust actions—such as acting against cartels or other collusive behaviour. The Government has not proposed giving any such anti-trust powers to the FCA, and the OFT would be very concerned if it did. In the case of anti-trust actions, the need to develop and follow a consistent body of law is even more marked than around market studies. International cooperation with other national competition authorities can be a critical ingredient in pursuing actions against large, international groups. The FCA would have none of this expertise or the necessary relationships.

Turning to my third point, we have supported a range of further alternatives—in addition to setting the competition objective for the FCA correctly—to “lock in” a pro-competition approach to the work of the FCA (and, in some respects, the PRA).

These include:

— Giving more consumer bodies with an interest in financial services, such as any successor to the FSA’s Consumer Panel, the right to make supercomplaints directly to the OFT, mirroring the powers currently enjoyed by, for example, Consumer Focus and Citizens Advice. This would allow such organisations to refer issues directly to the OFT for rapid consideration, ensuring that those issues were prioritised. It would allow the OFT to continue to become involved in assessing the impacts of financial regulation on competition, where such bodies regarded it as important. The OFT has, over the past 18 months, carried out work on cash ISAs, credit brokers and debt management companies, and travel money as a result of supercomplaints (the last of these under way at the moment);

— Placing both the FCA and PRA under the same requirements as government departments to respond publicly to recommendations from the OFT. At present, government departments undertake to respond to recommendations from the OFT arising from market studies within three months. Not being part of the Government, these requirements would not apply to the FCA and PRA but would, I think, be regarded as best practice by business. The Government has adopted a proposal related to this;

— Rather than having powers to make market investigation references to the CC, giving the FCA the ability to refer markets to the OFT, with a requirement on the OFT to consider them and respond setting out whether or not it will take action. Again, the Government has made a proposal related to this; and

— The FCA and OFT cooperating more fully, for example where anti-trust and financial market abuse issues may overlap. We have some experience of doing this, but there is undoubtedly more scope to do so. We currently have an MoU that covers aspects of the work of the OFT and FSA, and some coordination arrangements but this would benefit from being reviewed as the FCA and PRA are set up in light of their remits.

John Fingleton
Chief Executive

November 2011

Written evidence submitted by HB Markets plc

RESPONSE TO HM TREASURY'S WHITE PAPER: "A NEW APPROACH TO FINANCIAL REGULATION: A BLUEPRINT FOR REFORM"

1. Q. *The proposals are predicated on an assumption that the UK (as well as other member states) wishes to continue with its increasingly submissive position within Europe. Has the UK electorate decided or been given the opportunity to decide on this state of affairs?*

A. No. In 2010, a Referendum allowed for UK citizens to decide on proportional representation. Calls for the same in relation to ceding the powers of Westminster to Europe have gone unanswered. This is not a Europhobic statement but rather a query as to the state of UK democracy which itself serves to alert the UK electorate to consider the same as well considering the ability of their elected politicians in Westminster to take genuine executive action unfettered by external interference. One wonders to what extent the proposals have been actually decided upon by elected representatives in Westminster as opposed to being handed down by the EU. Figure 1.A on page 8 of the Paper omits reference to these EU regulations. We wonder why.

2. Q. *The UK government talks about retrieving some of the UK's decision making powers which have been handed over to Europe during the last 40 years. These proposals if put into effect, will have the opposite effect and place yet more executive power in the hands of European bureaucrats as well as increase costs still further. On what basis is this good for the UK and, more particularly, good for UK savers?*

A. We doubt that it is. It is patently clear that UK financial institutions are both active and successful worldwide. On the assumption that firm rules relating to transparency and financial solvency are in place, it should be left to competition to ensure that excellent quality products and services are offered. This would be similar to what has occurred in the car industry over the last 100 years ie universal standards of design and safety are agreed then individual manufacturers design their best products based on these.

3. Q. *What is financial stability? How will this be measured? An apparently good looking investment can with hindsight appear to have been ill-advised*

A. Indeed. Prescribed Costs, Access and Terms have not prevented many ISA products invested in an FTSE All Share tracker fund losing money over the last 12 years ie CAT regulations did not stop customers losing money in the longer term.

4. Q. *How will the proposals be funded? Has anyone worked out how many new staff will be required to achieve this new structure?*

A. We are not aware of what the costs might be but suspect these will be large. On the other side of the coin, it would appear to be a system which will provide jobs for unemployed people and that can only be commendable. No doubt the government has done its sums and worked out that the saving in benefits would outweigh the staff costs.

5. Q. *How will globalisation work when countries world wide have diverse fiscal and monetary policies? The euro-zone hasn't worked. What is the rationale therefore for an even larger entity with such diversity? How will consensus be achieved? Many still complain that basis upon which we went into Europe as flawed and ill-conceived. Does it make sense to build an even larger enterprise based on a premise which some argue was never viable? And why the reverence of all things large?*

A. We do not know. In our opinion, it would be far better to focus on people rather than ever larger organisations. Smaller groups of people with day-to-day responsibility and encouraged to take an interest in promoting sound financial and regulatory conduct represents our preferred option.

6. Q. *FPC: one really has to question its independence. But even suggestions from respondents, for example, to have an independent chair and NEDS appointed by the Treasury cannot remove the inevitable conflicts that will arise. How will the Treasury make decisions about who to appoint? Will its decisions be independent of party politics?*

A. On the face of it, probably yes to the last query but this does not change the ongoing risk of a conflict of interest and the notion that layer upon layer of regulation combined with micromanagement by outsiders does not represent the optimal way to ensure financial stability as well as top quality products and services for customers.

7. Q. *Valid objections to tri-partite governance of regulation between the FSA, HM Treasury and the Bank of England have been voiced since the 2008 crisis. With this in mind, is there any real difference in what is being proposed now with the FPC, the PRA and the FCA. And that is only at local level. What are the costs of ensuring a coherent interaction? Who will monitor this inter-action?*

A. Again more questions than answers. It all seems rather like bureaucracy for bureaucracy's sake—much centrally supplied by the EU to be subsumed into legislation ostensibly created by elected UK decision makers. Due to previous and often obscure treaties, this is doubtless legal but it is far less clear whether it is democratic.

8. Q. *The PRA will be authorised to judge safety and soundness of individual firms and to take supervisory and regulatory action. How can this authority exist independently of the FCA's supervisory role over conduct which is all too often the root of problems in firms?*

A. We do not know but we do see the distinct possibility that this will lead to confusion and higher costs without necessarily giving rise to meaningful benefits for the UK customer.

Summary

Whilst we agree that putting the Bank of England at the centre of the new regulatory model is good in principle, the proposals as they stand bring layer upon layer of new complexity so that it is difficult if not impossible to gauge potential benefits and almost certainly increased costs.

The success of the new framework will significantly depend on streamlined cooperation in order to bring improvements. Much will depend on the PRA and CPMA, in particular, and their ability to effectively regulate and cooperate without becoming overbearing.

We have real doubts about whether the changes outlined will actually result in measurable improvements and fear that, on the contrary, the new structure may prove fruitless in its quest to improve regulation and financial stability.

Over and above these issues remains the influx of EU-sourced regulation trickling into each and every aspect of our legislation. We are not advocates of the notion that "bigger is always better". In the context of financial regulation, it is our opinion that a proposal based on domestically agreed simple concepts of transparency along with the promotion of an active, competitive marketplace would represent a better option.

In recognising the unlikelihood of this occurring, we hope that the direction now seemingly being taken will result in a more stable, dynamic regulatory framework for the UK and one which supports its world class financial institutions and services rather than stifles them.

October 2011

Written evidence submitted by the City of London Corporation

Introduction

1. The City Corporation welcomes the opportunity to contribute to the Committee's scrutiny of the role of the Financial Conduct Authority as a key component of the proposed regulatory structure.

2. The City is a strong advocate of a regulatory structure for UK-based financial services that will enhance the stability of the financial system, restore public confidence and safeguard the competitiveness of the sector. A healthy and thriving financial services sector provides funding and other support for business growth (including smaller businesses), creates employment, generates export earnings and produces tax revenue in order both to address the deficit and to finance public service provision. This UK-based activity therefore needs to remain competitive if Britain is to continue both to attract international business and to prosper in global markets.

3. The Corporation's work on financial regulation matters is informed by the International Regulatory Strategy Group (comprising senior representatives from a variety of industry sectors including investment banking, asset management, insurance, legal and accountancy services, exchanges and market infrastructure). Its role includes identifying strategic level issues where a cross-sectoral position can add value to the expression of views from particular sectors.

4. In the current economic climate it is clear that constructive collaboration is required between authorities and industry. Confidence in the financial services sector's ability to generate growth has been dented and maintaining the status quo in terms of financial supervision is not a realistic option. The need for adjustment to the regulatory framework is widely acknowledged as being necessary.

5. This memorandum addresses general issues to which the City is in a position to respond. It acknowledges that there are widely differing views across business sectors and between companies and trade bodies. It does not seek to offer a consensus.

Roles and Responsibilities of the New Bodies

6. A particular concern in the new regulatory structure is that firms may be faced with being supervised by two separate regulators, since it appears that the authorisation of firms and individuals will be an overlapping responsibility between the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). It is essential therefore that time-consuming duplication of work between these regulatory authorities is avoided, with an integrated model used as far as possible. There is also a risk in the new structure of separate and distinct rulebooks being produced by both the PRA and the FCA, particularly in the area of prudential regulation, where the two regulators share responsibilities. A single and consistent rulebook is essential for all regulated entities.

7. Authorisation should be dealt with by one authority, in order to ensure the efficient and consistent delivery of regulatory decisions. Giving the FCA responsibility for collecting fees from regulated firms reinforces the argument in favour of giving it also sole responsibility for the authorisation of individuals and organisations, in order to avoid duplication and to create a direct link between the handling of applications and the granting of authorisation.

8. The move towards a judgement-based approach, away from consultation and analysis, is likely to be detrimental to UK-based firms. Indeed, the PRA/FCA judgement-based approach may conflict with the move to a single rule book and supervisory convergence at the level of the European Supervisory Authorities, which the industry broadly supports. With the transfer of power to the ESAs there is a concern that national authorities might be tempted to use Pillar 2 powers to apply higher standards in an opaque fashion. There might therefore be a need to define more tightly the scope within which judgements may be made.

9. In addition, the new structure does create the possibility of duplication. This includes the proposals to separate out the FSA's existing authorisation, enforcement, and rule-making functions between both the FCA and the PRA. There is a clear need to examine more closely the level of benefit gained against costs incurred. If the supervisory duplication within the new structures materialises, there is a risk that the costs of these proposals may exceed those set out in the assessment. The estimate in the original impact assessment of transitional costs of £50 million spread over three years seems low in view of the scale of the reorganisation required.

10. The Government consultation implied that the main dangers that the changes in regulatory structure were designed to address were bank or building society failures on the pattern of the events of 2007–08. There can, however, be occasional failures in the non-banking area of the financial services sector. Effective powers of intervention should be in place to resolve such crises, although in the event of the failure of a non-banking institution, the appropriate point of intervention will need to be identified at the time, rather than setting a mandatory defined threshold.

11. While it is acknowledged that the approach of the FCA to regulated firms must on occasions be robust and adversarial, for instance when taking action before issues of consumer detriment become too entrenched, or in the treatment of clear failings in public policy areas such as the prevention and detection of money-laundering, it is also desirable that creating an atmosphere of mutual respect between the Agency and those it regulates should be an aim.

Financial Policy Committee

12. Both the FCA and the PRA should have regard to the primary objectives of the Financial Policy Committee, since it is the body charged with setting the parameters to achieve financial stability across the system.

13. The emphasis of all three new bodies should be on the quality and relevance of the information and intelligence they require and gather from regulated firms and markets, rather than its volume. The accumulation of reports and returns when there are neither the will nor the resources to process such information properly is of no benefit to good regulation and supervision and can contribute to an atmosphere of hostility between regulators and those they regulate.

Other Issues

14. The proposed changes in the UK's regulatory structure will of course take place as rule-making powers move from domestic authorities to the new system of EU-wide supervisory institutions. The banking supervisor is based in London and it is essential that the new UK bodies, from the start, seek to influence the development of the EU-wide regulatory and supervisory structure, encourage secondments and develop a dialogue with equivalent bodies including those in the United States and the emerging financial centres of the Middle East and Asia. However, the UK authorities appear to be playing down the role of the ESAs, which could undermine the development of sound and effective regulation at the EU level if this results in the UK being less engaged.

15. The requirement for the FCA (and other regulatory bodies) to have regard to the competitiveness of the UK financial service sector is very strongly endorsed. Proper and effective regulation is essential for financial stability and both domestic and international trust and confidence and is the main mandate for the new authorities. It is however important that they should share the responsibility of HM Treasury to promote the competitive position of the sector, as a major contributor to employment, export earnings and tax revenue. It

is essential that this position is not undermined by regulatory requirements and approaches which exceed in their prescriptive nature those of partners and competitors.

November 2011

Further written evidence submitted by the Office of Fair Trading

Further to my letter of 7 November, I am writing again to set out in greater detail the Office of Fair Trading's (OFT's) view on the remit of the Financial Conduct Authority (FCA), with regard to competition.

We believe that the FCA should have a top-line objective to promote competition in its rule-setting and regulation of the sector. We do not believe, however, that fulfilment of this objective requires the FCA to have concurrent powers to make Market Investigation References (MIRs) to the Competition Commission (CC), and that it may have unintended consequences. I explain this further below.

MIR powers cannot be effectively exercised in isolation from wider competition enforcement powers. The MIR tool addresses features of a market which cannot be adequately tackled through the enforcement of consumer and competition law. Where problems in markets can be tackled through enforcement this is preferable, not least because it enables the establishment of cross-economy precedents with stronger deterrent effect. It also carries possibilities of consumer redress.

The proposal to grant MIR powers to the FCA risks undermining this principle of the primacy of enforcement action, which could inadvertently weaken competition within the sector. The FSA has suggested that the need to consider the interactions between any possible MIR and potential enforcement action under the Competition Act 1998 (CA98) for collusion or abuse of dominance could be overcome via liaison between the FCA and the competition authorities before any financial services' MIR is made. We do not believe such an approach is desirable or possible because the consideration of competition enforcement issues is an integral part of the MIR decision-making process. In our experience, market studies often reveal a complex competitive landscape which demands a range of responses including, potentially, both CA98 and consumer enforcement as well as possible MIR action. Such situations arise regularly and the issues are frequently hard to disentangle.

In addition, there may be complex interactions with the European Commission's jurisdiction to enforce Articles 101 and 102 of the Treaty on the Functioning of the European Union. We are bound by strict legal constraints on information sharing about these often highly sensitive cases. Circumstances could therefore arise where, despite a requirement to consult or liaise, we were unable to share with the FCA information which might be highly relevant to its investigation.

The proposal could also have the consequence that the ability of the OFT (or the future Competition and Markets Authority) to use its competition tools in financial markets is diminished or compromised. In particular, it risks the fragmentation of roles, weakening the ability of the competition regime to support the Government in tackling strong vested interests, and gives rise to the risk of overlaps or, more likely, gaps in action. As I mentioned in my previous letter, the ability to review financial markets is vital for the OFT as a national competition authority.

This brings me to the FSA's recent supplementary evidence that calls for MIR powers in the financial services arena to be the sole preserve of the FCA. Our concerns would be significantly increased by this proposal, as it would contravene the existing principle whereby national competition authorities are able to act across the whole economy even in areas where other sectoral regulators have competition powers. It would also aggravate the concerns outlined above about ensuring that CA98 enforcement and MIRs are complementary.

Moreover, it is likely that the FCA will have strong incentives to use its regulatory powers in preference to making MIRs. In some cases this may lead to more rapid outcomes. For example, remedies to promote consumer switching which could result from an MIR to (eg, as in PPI) could hopefully be applied directly by the FCA. The danger, however, is that such remedies are not imposed in the light of the fresh analysis envisaged by the two-phase approach to market review at the heart of the UK competition regime. The area of greatest need of and most powerful use of an MIR—where it could shine a light on FCA rules that do not promote competition—might not be the first priority of the FCA and, as a result of this proposal, might not be available to the independent competition regime. The overall effect may be that MIRs are less, not more frequently, made in the financial services sector.

Finally, these questions need to be considered in the light of the Government's proposed reforms to the UK competition framework, which seek both to provide for more flexible use of resource between the two phases of the market investigation regime, and to provide a single, more powerful advocate for competition in the UK and internationally. Granting MIR powers to the FCA would, in the OFT's view, run counter to both these objectives.

John Fingleton
Chief Executive

15 December 2011

Written evidence submitted by Brewin Dolphin

A NEW MODEL FOR REGULATION, PROTECTION AND COMPENSATION IN THE RETAIL AND PRIVATE INVESTOR MARKET IN THE UK

Background

It was rightly pointed out at the launch of the FCA that we have a "once in a generation opportunity" to ensure the regulatory system in the UK is fully fit for purpose. We believe the FCA can achieve this goal by working more closely with the industry to learn from the problems of the past and prevent many future difficulties. However, we believe the opportunity is in danger of being missed.

As far as the private investor industry/Wealth Managers understand, there has been little effort to identify accurately where and why the product failures and consequent losses have occurred in the past, or to produce an adequate response to them. Instead we appear to be entrenching a "one size fits all" structure and replacing face to face regulation with call centres and modelling. In combination these measures look unlikely to supply an improvement on the status quo and better investor outcomes.

We believe a different and innovative approach to the FSA's "simplified advice" and product intervention plans could help to achieve a greater level of confidence and certainty for the vast majority of consumers. We also very much welcome the Treasury's announcement that a new Steering Group is being launched under the Chairmanship of Carol Sergeant, to consider a range of "simple" financial products.

Further Reforms

This paper, therefore, proposes further reforms which will offer enhanced protection for the most vulnerable savers while differentiating between the diverse ranges of products and services provided by the industry. They build on two FSA proposals of simplified advice and product intervention, to achieve this. We believe it will lead to better protection, more affordable regulation and guard against future mis-selling.

At the launch of the FCA, Hector Sants said that "in practice consumers do not pay enough attention and lack the skills to make financial decisions and that it should therefore, fall to the regulator to make judgements on behalf of consumers, even if that resulted in lower personal freedom". While this approach may be too draconian for the wealthier and/or more sophisticated private investors, we agree that it could be appropriate for a large swathe of consumers, many of whom may also find it difficult to get affordable financial advice post RDR. We share the belief of some consumer groups that less sophisticated investors are owed a higher duty of care by both regulators and the firms that seek to serve them. We therefore suggest that there should be two approaches to providing advice, products and services to private individuals in the UK.

New Model—Part 1

We would like to see enhanced protection for retail consumers in a simplified product range of the key building blocks which should make up the core, or in many cases all, of the savings of the vast majority of savers.

These core services will cover all the basic savings needs of a family or individual. For savings products, we would not envisage any providers being authorised from outside the IMA, ABI and BBA members. The product range could include simple cash products, personal pension plans, index linked and other savings bonds, gilts and ISAs holding some very basic equity funds (principally index tracking, but possibly multi manager, balanced or lifestyle).

We suggest that National Savings can be used as a benchmark for these products, in terms of performance, price and the issuers' willingness to stand behind their products should they fail to do "what they say on the tin" or lose value below prescribed benchmarks. This will reduce chances of mis-selling or inappropriate product engineering for an audience which is likely to be lacking in financial education and financial resources.

All such products would be developed to a prescribed formula and require pre approval from the FCA. The organisations providing such products will all have the financial strength to stand behind their products. They will not have hidden risks or hidden charges and where possible should be tax advantaged.

Enhanced Protection

The key to these products is that they can be distributed with or without financial advice. Thus consumer protection will lie not at the point of sale but rather within the product itself. In other words, not the current somewhat contradictory "simplified financial advice", but simple and "safer" financial products, which consumers, Regulators and Government can all have sufficient confidence in. This will also allow resources to be directed elsewhere.

The Advice Gap

This should also help to address the worries prevalent in HMT about the advice gap, because fully automated factual services or organisations like the Money Advice Service (MAS) should be able to get these customers to a point of sale safely and correctly informed.

The point at which an individual needs to move beyond this product range is open to debate. However, if they choose to do so, either with or without advice, they should be clearly informed that they are incurring an increased element of risk and therefore an element of caveat emptor—as also stated in the Principles in HMT's A new approach to Financial Regulation at 4.26 February 2011—that consumers are ultimately responsible for looking after their own interests and the choices they make.

Our own belief is that the proposed simple products would cover most savings needs for an individual with less than £75,000. However, the key issue is not so much the size of investable assets; rather it is that the individual themselves requires an understanding of the possible risks and the protection provided for different types of investments. Put another way, it is the moment at which savers move from being a consumer to an investor, which has some important connotations.

New Model—Part 2

The more sophisticated requirements of private investors will principally be catered for by wealth managers, stockbrokers, and private banks, larger IFAs and fund managers, most of whom will be members of APCIMS, BBA and/or IMA.

While there is clearly no distinction between retail consumers and private investors under RDR or MiFID, we deliberately use different descriptions here to suggest that we are moving into an arena where the customers will be able to afford to pay for independent and professional qualified financial advice. All the companies in the categories above will also have, or should have, insurance and capital adequacy requirements sufficient to go at least some of the way towards compensating their clients should it be needed.

The companies providing product or services to this group of investors should be vetted and approved by a joint body of FCA and practitioners (not unlike the old Stock Exchange membership) to limit the chances of failure or rogue operators. While the FCA would be the ultimate decision maker, input from the industry would be helpful in identifying potential problems which is in the mutual interest of firms and the Regulator. Membership should be permanently under review with the body authorised to investigate comments or whistle blowing from industry participants. This will lead consumers to have increased confidence in the firms authorised by the FCA. If IFAs are not sufficiently competent or financially strong enough under RDR to be in this group, they should only be permitted to provide advice on simplified products.

Clear Information for Consumers

Between these two approaches, the vast majority of private investors in the UK will be catered for. Should an adviser take a client beyond simplified products, this will have to be clearly stated so that even the most poorly informed consumer will realise they are being moved into more risky territory. Should retail consumers or private investors choose to purchase products from a provider which is not itself FCA regulated (or their advisers recommend they do) they should be clearly informed by law that they will be giving up some or all of their rights to compensation. A clear advertising campaign should be used to make all consumers aware of that danger.

We believe that such a proposal brings a number of clear advantages.

- In building on the two FSA proposals of simplified advice and product intervention and the HMT's Simple Products intentions, it will not require another major new initiative or legislation.
- It does introduce an element of caveat emptor, but only in a way that allows risk averse, unsophisticated or less wealthy investors to avoid it.
- Investors will have a range of products with enhanced protection offered by a group of firms with the financial strength to stand behind their products, including NS&I.
- There will be a clear flag to retail consumers when they are moving outside this area of highest protection, presumably in pursuit of more complex or higher return investments such as complex structured products, specialist equity funds or investment trusts, individual equities or corporate bonds and hedge funds. This will help consumers become more educated about the relationship between risk and return as well as ensuring that advisers only recommend other investments where they are suitable for the client.
- Banks and institutions providing simplified products will become very competitive, with transparent and capped charging structures.
- There will be a clearer "ladder of risk" which should lead to less mis-selling.
- It will lower the potential impact from the failure of under-regulated and misunderstood companies such as Key Data.
- It should reduce red tape and costs of retail regulation for all parties.

This provides an opportunity for the Government, the regulator and the industry to re- contract with consumers in a clear and simple fashion. Consumers will have protection, particularly the most vulnerable, but not unlimited guarantees. It will also begin the process of rebuilding confidence in the investment industry, which is so important to growing the savings that will be needed to meet retirement incomes in the 21st century.

9 December 2011

Printed in the United Kingdom by The Stationery Office Limited
01/2012 016585 19585