THE FINANCIAL SERVICES PRACTITIONER PANEL

September 2011

FINANCIAL SERVICES PRACTITIONER PANEL
EVIDENCE TO THE
JOINT COMMITTEE ON THE DRAFT FINANCIAL SERVICES BILL

EXECUTIVE SUMMARY

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.

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.

Overall we do see clear benefit in the legislation establishing the FPC to address macro-prudential risks, and believe this will help to avoid any similar future crisis. However this could probably have been achieved as an addition to the current regulatory structure. We are concerned about the cost and disruption caused by the Government's changes, and the potential weaknesses of the "twin peaks" model as set out in our answer to Question 1. However, much is being done to mitigate those risks, and we have taken an active interest in the development of the plans within the FSA since the Government first announced its intention to change the regulatory system.

The key points of the Panel's submission are summarised below. The Panel would welcome:

1. More specific details on co-ordination between regulatory authorities, including a general duty to coordinate being included in the regulatory principles and in areas including systems and controls and review of business models.
2. Increased focus on cost management and controls.
3. A requirement for the PRA (as well as the FCA) to establish a statutory Practitioner Panel.
4. Governance structure to counterbalance the concentration of powers in the Governor of the Bank of England.
5. Introduction of a 'have regard' to competitiveness in the regulatory objectives.
6. Input from industry in the development of the FPC's macro prudential tools.
7. Re-emphasis of the need for proportionate regulation and greater clarity on how judgement based regulation will be implemented.

8. Encouraging a culture for the new regulatory bodies which places great emphasis on recruiting and retaining high quality staff with commercial expertise.
9. The FCA's increased safeguards to ensure that the broad definition of 'consumer' does not result in inappropriate retail approaches being applied to wholesale markets.
10. Clear communication channels between the FCA and the Bank of England in respect of markets, in particular so that there is strong influence over and involvement with the European equivalent authorities.
11. Greater emphasis on the responsibilities of consumers in respect of conduct regulatory matters.
12. Greater clarity on the FCA's risk appetite, which should be communicated as soon as possible
13. Safeguards over the publication of early warning notices.

We would be happy to give further evidence to the Committee on any aspect of the changes. The Panel's answers to the Committee's questions are set out below.

1. Is the separation of prudential and conduct regulation into a "twin peaks" system the right approach?

The Panel recognizes that there are arguments both in favour of and against the introduction of a twin peaks regulatory system. There are also a number of ways of implementing such a system, as has been seen by the discussion around the different consultations. We would like to highlight that it is how the new system is implemented – including the transition period, the adoption of new cultures in these regulators, and systems in place for cooperation – that will be just as important as the overarching regulatory system adopted.

From the industry's perspective, we wish to ensure that the potential disadvantages of any system are mitigated. In the twin peaks system, our key concerns are around coordination and cost. A move to a regulatory system which relies on several separate regulatory bodies for prudential, conduct and system-wide supervision must ensure that it has arrangements in place so that no regulatory issue 'falls between the cracks', i.e. that no potential issues are lost. It will also be just as important to ensure that there is no regulatory overlap, with unnecessary duplication of regulatory responsibilities, causing confusion within firms as well as duplication of costs in any system going forward.

In terms of costs, the industry wishes to see that any initiatives that carry additional costs can be justified on the basis of value for money. The Panel strongly supports high quality regulation, but it is important that efforts and monies are targeted in the areas where they make the biggest difference. As such, the Panel urges that there is clear monitoring of costs as well as cost benefit analyses of new initiatives going forward. We are concerned that in the organisation of the PRA, there is no opportunity for the industry to suggest more cost efficient means of working as there are not current proposals for statutory Panels and regular engagement with the industry, as with the FCA. We are not suggesting accountability to the industry, but believe that the current lack of any statutory engagement with industry at the PRA creates a weakness in the system.

2. What lessons can be learnt from the approach of other countries to regulation of the financial sector?

No answer submitted

3. Is it appropriate to make such major changes to the regulatory system by way of amending legislation, rather than starting afresh?

No answer submitted

4. Are the accountability and governance arrangements for the Bank of England, FPC, PRA and FCA satisfactory?

We believe there is a strong case for including a statutory Practitioner Panel not only for the FCA but also for the PRA going forward. We are not asking for the PRA to be accountable to the industry, but there should be a forum for regular engagement and dialogue with the industry, embedded within its operations. Including some form of a statutory Panel with close links to the FCA Panel would have key advantages in allowing practitioners to identify when regulation in one area (say mortgages) may have unintended consequences in another area. It would further monitor effective coordination between the different regulatory bodies and be able to provide valuable industry input on a regular basis. A standing Panel would also be able to draw on its 'corporate memory' in providing advice. We have prepared a detailed paper on the need for statutory practitioner representation at the PRA which is included at Appendix 2 to this paper.

The Panel further notes that the current arrangements for the FPC, the PRA and the Bank of England concentrate a lot of power in the hands of the Governor of the Bank of England. There are very few checks on this power, or indeed the power for the Bank of England overall, and we would encourage a re-think in this area.

We are also concerned about the balance of FPC membership, which is currently dominated by the Bank of England. The Government has undertaken to consider this further in the White Paper published in June 2011. We have urged the Government to ensure that there is more industry experience to ensure that measures suggested are practical, viable and will not cause unexpected knock on effects in the industry when implemented.

5. Are the FPC's objectives the right ones? Is the concept of financial stability adequately understood for the FPC to be able to perform against its objectives?

We believe that the concept of financial stability is generally adequately understood for the FPC's purposes, although we have previously highlighted that, unlike the MPC's inflation target, financial stability is very difficult to measure.

However, in addition, we would urge that the FPC's objectives are supplemented by a 'have regard' to the competitiveness of the UK industry. 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. Ongoing financial stability needs the support of an industry which is competitive in the global marketplace. 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.

6. **Should the FPC be limited in the actions it can take which might affect the growth of the financial sector?**

As discussed under question 5, the FPC should have regard to the competitiveness of the UK industry. This could mean that its actions may be limited in cases where the impact on the growth of the financial sector is significant. At the very least, it should include a requirement to let regard for competitiveness be the deciding factor in the choice between two otherwise equal choices.

We would also suggest that the Committee reflect on whether the FPC should not only consider growth of the financial sector, but also look at whether actions may undermine and reduce the size of the financial sector, or where its actions would seriously hinder the ability of financial firms to serve the interests of its customers.

7. **How will the interaction between macro-prudential and monetary policies be handled by the FPC and the MPC?**

In answer to this question, we would only note that monetary policy is easier for the MPC to measure with an inflation target than the FPC's objective of financial stability. It will therefore be important to ensure that the clearly measurable outcome of the MPC does not mean that monetary policy dominates the policy agenda in the Bank of England.

8. **Has the right balance been struck between the powers of the FPC and the powers of the Treasury?**

This is not a question where we can give much input. However, the Practitioner Panel is concerned about the concentration of power and accountability in the Governor of the Bank of England, so maybe it would be useful for the Committee to consider the balance with the Treasury and Parliament in the proposed set up.

9. **Can Parliament take an informed decision about the proposals for the FPC without details of the macro-prudential tools at its disposal?**

The Panel is concerned about the lack of detail as yet on macro-prudential tools, and believes that Parliament will need more detail – not necessarily on what these tools will involve, but on how they will be developed and used in the future.

The role of the FPC going forward will be key, both in directing the other regulatory bodies as well as in deploying its own macroprudential instruments. It is important that there is further clarity also on the exact powers these tools will give the FPC to direct the activities of firms through the PRA and FCA. We would be interested to see how input can be given to the FPC in highlighting mistakes or unintended consequences of any actions it takes – from the regulators themselves and from those affected by the FPC's directions.

These tools will have significant prudential and conduct implications for firms, but unlike in the FCA and PRA, industry has no way of inputting into the usage of these. The Panel would also strongly encourage the Bank of England to reach out to industry in the development of these tools, as we believe this could provide valuable help and expertise in this process.

11. Are the PRA's objectives clear and appropriate?

The PRA's overall objectives seem clear and appropriate. Our main concern is to ensure as much coordination as possible with the FCA. We would like to see that, as well as the general duty to coordinate, the duty to coordinate is also added to the regulatory principles. The Bill rightly recognises that cooperation between the regulatory bodies will be key in ensuring there is no overlap/underlap of regulatory activities. We believe that if the duty to coordinate was also in the regulatory principles, there would be more coordination on a day-to-day working level between the PRA, FCA and FPC.

12. Are there any risks in the Government's proposed 'judgement-based' regulation?

We believe that the key risk in the Government's proposed judgement-based regulation is that inconsistency of approach develops. This is from the level of individual supervisors within the PRA, through to comparison with those who are prudentially regulated at the FCA and through to UK regulators becoming out of line with international rule based regulators. It is vital to ensure that there are appropriate, clear rules in regard to oversight of judgement based regulation in order to ensure consistency between judgements, as well as a system of appeal for firms should they believe that a judgement is mistaken.

It is also harder to measure if a regulatory approach is proportionate under judgement-based regulation. It is important not to lose sight of the principle that the cost of regulation should be proportionate to the benefit, as well as the principle that the overall regulatory burden carried by any individual financial institution should be proportionate to the risks it poses.

The Panel sees the advantages of judgement-based regulation, but given the points above, would like to emphasise the importance of checks and balances (in the form of appeals processes and strong management oversight procedures) in any such system going forward.

13. Is the Government's proposed approach to 'orderly' firm failure satisfactory?

Whether the proposed approach is satisfactory is dependent on the current development of recovery and resolution plans. The Panel has been in discussion with the FSA in this area and followed the recent publication of the Recovery and Resolution plans consultation with interest. However, it notes that many issues remain outstanding (waiting for agreements on an international level) and that the details still need to be developed.

As such, the Panel will reserve its judgement on this issue until these plans are further progressed.

14. Given that the PRA and the FCA will inherit FSA staff does the draft Bill do enough to ensure a new regulatory culture and a more proactive approach to regulation? Will these two new bodies have staff with the appropriate skill and expertise?

The Panel has repeatedly emphasised the importance of the regulator recruiting staff with commercial expertise who are able to understand and challenge firms' actions effectively. This will continue to be the case in the new regulatory structure.

We believe that it may be more difficult for the FCA to change its culture, as it is growing out of the FSA and will remain in the same building. However, both of the new bodies will have new and challenging objectives, with narrower roles for staff in both regulators. This in itself will go a certain way to changing working cultures, but does not mean that the regulators can lose sight of the importance of recruiting and retaining high quality staff with commercial experience. This is especially a concern in light of the higher turnover (especially of senior staff) seen in the FSA since the announcement of a change to the regulatory structure.

15. Are the FCA's primary objectives appropriate? Is significant emphasis given to the promotion of competition?

The Panel supports the proposed objectives for competition for the FCA as appropriate. However, as discussed for the FPC under question 5, we believe that all the regulators should have an additional regard to the competitiveness of the financial services industry as a whole. 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.

The Panel is also concerned that the FCA's broad definition of consumers along the line that has been proposed does not make sufficient distinction between retail and professional consumers of financial services. Although we welcome partial assurances that different types of consumers will still receive different regulatory protection and treatment, there are great concerns around ensuring that this is the case in practice. It is vital to recognise that retail consumers need much higher levels of protection than professionals, the latter having 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.

The FCA's universal definition of consumer is also likely to encourage a tendency towards "one size fits all" approach to regulation. This is something that we have fought hard with 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.

16. Are the responsibilities of the FCA towards the regulation of markets appropriate?

The split of responsibilities in the regulation of markets between the Bank of England and the FCA will be challenging, particularly as this structure does not map neatly into the European regulatory structure. Given the importance of European Union regulation in this area going forward, it is vital to ensure that the voice of UK markets in Europe remains strong. There will need to be clear communication channels between the FCA and the part of the Bank responsible for markets infrastructure, otherwise there is a risk that a vital part of the UK market will not have a voice in European developments as the FCA will hold the UK seat on ESMA.

Within the FCA, there is a need to ensure that the FCA's responsibilities towards markets are not subsumed by the FCA's consumer protection role. We are pleased that this has been recognised to a certain extent with the creation of a Markets Panel. An additional way to help mitigate this risk would be to have legislation specify that the FCA must produce an annual report, or undertake annual Value for Money studies, of how it is undertaking its market responsibilities specifically.

17. Does the draft Bill strike the right balance between the responsibilities of consumers and firms? Are the FCA's new powers in the area of consumer protection appropriate?

The Panel is concerned about the balance between the responsibilities of consumers and firms for the FCA. Although consumer responsibility is listed in the regulatory principles, the Panel remains concerned that there is still not enough emphasis in the White Paper or Bill on the need to retain a balance between consumer and firm responsibility. For example, the FCA Approach document does not address how it will deal with consumer responsibility. The FSA has had a similar remit towards consumer responsibility, and yet it has never been properly defined how the regulator should carry this out. The current legislation is an opportunity to set out clearly the balance between consumer protection and responsibility. If the FCA is not to be a zero-failure regime, then it must declare where the responsibilities of consumers, as well as firms, lie. The Panel would strongly encourage greater clarity in this area.

Overall we would urge that it is made clear that the FCA should, as a regulator, be seen as unbiased and fair. We have some concerns that, in seeking to show that the FCA will be different from the FSA, it will look to focus on criticism of the industry. This will not help to instill confidence in the industry in the long term.

18. Are the prudential regulatory responsibilities of the FCA towards FCA-only regulated firms given sufficient emphasis and detail?

The Panel does not believe the prudential regulation role of the FCA has been given sufficient emphasis and detail as yet. Given that the majority of firms will be FCA-only regulated, this is a significant omission. As the FCA Approach document, published in June 2011, gives very little detail of its plans for prudential regulation, it is difficult to comment on this area at the moment.

19. Will the new regulatory arrangements reduce the risk and cost of dealing with miss-selling of financial products?

The regulatory arrangements in themselves will not make much difference to the risk and cost of dealing with mis-selling, but what will be important is the way that the regulator carries out its role, and the people it employs. The FSA has been moving towards earlier intervention, and we understand that the FCA will carry this forward.

It is not clear at the moment whether the FCA will aim to reduce the risk of mis-selling to zero. We have asked the FCA to be clearer about its risk appetite, so that an acceptable level can be agreed by all. The cost implementation of trying to catch all potential instances of mis-selling would be huge, and may stifle the market. It would also require hugely greater resources than are currently envisaged for the FCA.

Much of the change in emphasis for the FCA has focused on the new intervention powers that it will be given. However, we believe that the problems more often arise when products have been developed correctly for a specific target market, but are later sold to a wider market, and so the sales become inappropriate.

20. Are the proposals for co-ordination between the PRA and FCA clear and adequate? What would be the advantages and disadvantages of having a Single Point of Contact and/or a joint rule book for dual-regulated firms?

As discussed under question 11, the Panel believes there should be a duty to coordinate in the regulatory principles. Without this, there is a concern that the duty to coordinate may be lost in the day-to-day work of the regulatory bodies. There are a number of areas which will cut across the responsibilities of both regulators (including systems and controls and business models), and without strong arrangements to ensure coordination, there could be significant regulatory overlap/underlap with efficiency and cost implications both for the regulators and for firms.

This is also one of the reasons we advocate statutory Panels for both the PRA and FCA, with strong links between them going forward – to provide engagement and feedback on coordination between the regulatory bodies.

21. How do the proposals in the draft Bill fit within the new European regulatory regime? What freedoms and constraints will the UK have to operate within that regime?

The proposals in the draft Bill can be made to fit with the new European regulatory regime, although not in a smooth manner. 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.

22. Does the draft Bill contain any proposals or omissions, not covered by the questions above, which cause concern?

The Panel does have serious reservations around the publication of early warning notices, although it welcomes the additional safeguards proposed in the new FCA document and the Bill. Our concern is that even with the requirement to consult the relevant person before publication, there are serious potential regulatory and legal, as well as moral, implications of proposals to publish such notices before a person has been proven guilty.

Whilst we remain sympathetic to the supposed rationale behind the proposal – to ensure that consumer detriment is minimised in cases where the regulator suspects a person/product of being not being up to standard – this could have significant negative implications for both firms and consumers. In cases where consumers hold a given product and then see a warning notice, they may feel compelled to sell at a fire-sale price. Should the product subsequently be shown to be safe, consumers may have suffered financial detriment, in addition to the detriment of restriction of product choice (since the product is then unlikely to be able to be sold in any case).

APPENDIX 1

ROLE AND REMIT OF THE PRACTITIONER PANEL

1. The role of the Practitioner Panel is to advise the Financial Services Authority on its policies and practices from the point of view of the regulated community. It has statutory status under the Financial Services and Markets Act 2000 (FSMA). As such, the Practitioner Panel is given access to the FSA's plans for new regulatory policies, and so is able to provide an important sounding board for the FSA before the ideas have been made public.

2. Members of the Practitioner Panel are drawn from the most senior levels of the industry, with the appointment of the Chairman being formally approved by the Treasury, to ensure independence from the FSA. The members are chosen to represent the main sectors of the financial services industry as regulated by the FSA. The Panel currently has senior practitioners from the retail and investment banks, building societies, insurance companies, investment managers, financial services markets, custodians and administrators.

3. The Chairman of the FSA's Smaller Businesses Practitioner Panel (SBPP) sits ex officio on the Practitioner Panel to ensure co-ordination, but debate on issues specifically affecting smaller firms are covered by that Panel. The SBPP is submitting a separate response to this Consultation.

4. The names of the members of the Practitioner Panel as at 1st September 2011 are as follows.

Russell Collins (Chairman)	Partner, Deloitte LLP
Graham Beale*	Chief Executive, Nationwide Building Society
Joe Garner*	Head of UK Retail Bank & Deputy Chief Executive, HSBC Bank plc
Paul Geddes*	Chief Executive, RBS Insurance
Colin Grassie	CEO, Deutsche Bank UK
Mark Harding	Group General Counsel, Barclays Bank PLC
Simon Hogan	Managing Director, Institutional Equity Division, Morgan Stanley
Garry Jones	Group Executive Vice President & Head of Global Derivatives, NYSE Euronext
Guy Matthews	Chief Executive, Sarasin Investment Funds (SBPP)
Helena Morrissey	Chief Executive Officer, Newton Investment Management
John Pollock*	Group Executive Director, Protection & Annuities Legal & General
Andrew Ross	Chief Executive, Cazenove Capital Management
Malcolm Streatfield	Chief Executive, Lighthouse Group
Paul Swann	President & Chief Operating Officer, ICE Clear Europe
Doug Webb	Chief Financial Officer, London Stock Exchange Group

** Members from 1st September 2011*

APPENDIX 2

THE FINANCIAL SERVICES PRACTITIONER PANEL

Smaller Businesses Practitioner Panel
Financial Services Authority

JULY 2011

THE NEED FOR A STANDING BODY OF PRACTITIONER REPRESENTATIVES AT THE PRA

INTRODUCTION

This briefing is written on behalf of both the Practitioner Panel and Smaller Businesses Practitioner Panel, the current practitioner panels for the FSA. It is based on our knowledge and understanding of the contribution that the Panels make to regulatory policies, and we would like to contribute further to the ongoing debate concerning the need for statutory standing bodies for the proposed PRA. We recognise that these opinions might be viewed as being self serving; however, we do not believe that we have particular vested interests in the Panels continuing: members of the Practitioner Panel serve to make a personal contribution to the regulation of financial services and are unpaid (while the members of the SBPP receive only a small fee) and normally serve a maximum of two terms of three years each.

THE CURRENT PROPOSALS

The White Paper on regulatory reform published in June 2011 ("A new approach to financial regulation: the blueprint for reform") correctly distinguishes accountability (for example, to Boards/Court and Parliament) from engagement with stakeholders (for example, to Practitioners, Consumers). The White Paper is clear on the need for statutory Practitioner, Smaller Business Practitioner and Markets Panels for the FCA. However, whilst the White Paper proposes to give the PRA a statutory duty to put in place arrangements for engaging with practitioners, as drafted there will be no specification of what those arrangements might be. Therefore the arrangements would be at the discretion of the PRA and the Bank of England. The White Paper also indicated that the Government will continue to consider these arrangements in the light of further consultation and PLS.
As the current statutory practitioner panels of the FSA, we wanted to set out what our experiences indicate are the advantages of having a statutory standing body of practitioners with strong links to the FCA Practitioner Panels, possibly in the form of a statutory Panel, and also what we see as the disadvantages of not having such a forum for the PRA.
We believe that engagement with the industry at an early stage of policy development has significant benefits for regulators as well as firms. The Government has recognised this in the proposed structure for the FCA, but not in the PRA, although the reasons for the distinction are not articulated clearly and the distinction seems to us to be misguided , particularly as each body has the same policy-making functions. We believe that such a

structure for industry consultation via a standing body is not relevant only to the FCA: it should also be incorporated into the set up of the PRA.
We do not accept that setting up a standing body for the PRA would increase the risk of "regulatory capture" given the powers and responsibilities of the regulators enshrined in the legislation. In this regard, we welcome the comments of Hector Sants in his speech to the PRA conference on 19 May 2011: "Avoiding regulatory capture does not mean, however, that the PRA will not engage with the firms it regulates. In particular in making its rules, the PRA should do so in full understanding of both their impact and the industry's perspective. It will accordingly set up the necessary consultation mechanisms to ensure the right people in industry are involved. Where necessary this could include standing advisory committees. Furthermore when it makes its rules it will set out their purpose in a clear and straightforward manner."

DISADVANTAGES OF NO STATUTORY STANDING BODY/PRACTITIONER PANEL

We believe that there are distinct disadvantages in not having a statutory Practitioner Panel with strong links to the FCA Panels at the PRA, even if there were to be either standing bodies or ad hoc groups gathered together for specific aspects of PRA regulation at the discretion of the PRA and the Bank. The main disadvantages of non statutory ad hoc groups or standing bodies are as follows:

- Groups drawn together for specific issues will only be focussed on that part of regulation and so may not recognise the impact that such an action may have on other aspects of the system, its interaction with other rules already in place or in prospect or the opportunities for coordination and economies of scale in implementing different changes at the same time. For example, there has recently been considerable debate about the fit between Basel III (and its requirement for banks to lengthen the maturity of their liabilities) and Solvency 2, which may make holdings of bank term debt more expensive, and hence less attractive, to insurance companies. These linkages could well be missed by two single sector groups.
- The division of regulatory issues into Conduct and Prudential at the FCA and PRA, whilst it may be a useful construct for supervisory purposes, is somewhat artificial: from the viewpoint of practitioners (and government), it is the cumulative impact of regulation that matters, especially in regard to maintaining financial stability, protecting consumers and ensuring the UK has an internationally competitive financial services industry.
- The 'corporate memory' of the Panel means that they may recognise links and repetitions that may not be obvious to ad hoc groups, and would be able to look at the impact of proposals when combined with FCA rules or proposals if there was strong linkage, or even some common membership with the FCA Panels. Although standing bodies might achieve this, we believe that a statutory basis with a link to the FCA Panels would make the standing bodies much more effective.
- Deciding when an ad hoc body is needed or not could result in not having industry input precisely when it could be most beneficial, for example in making the case to the European Union regulatory bodies for regulations which can be properly applied in the UK, given its unique financial markets which is evidenced at the moment in the debate on maximum harmonisation of bank capital rules;

- Setting up various bodies will be time consuming and potentially inefficient. It also runs the risk of “missing the boat” insofar as engagement with EU policymaking is concerned.

REMIT OF A STATUTORY PRA STANDING BODY/PANEL IN THE NEW REGULATORY STRUCTURE

There are particular areas in the PRA’s remit which would provide opportunities for engagement with a Practitioner Panel as follows:

- The PRA’s future approach documents set out PRA responsibilities in regard to policy making. It says that the PRA will seek to ensure, wherever possible, that its policies and rules are straightforward, clear in intent, robust and support timely interventions. The PRA’s policy documents will explain the underlying purpose of its policies and rules. And the PRA will, wherever possible, include clear statements of purpose when setting rules to ensure that firms and the market more generally understand the reasons behind the policy. All these commitments would benefit from a regular and informed dialogue with a specific group of practitioners who also have links to the FCA Panels.
- The PRA’s (new) policyholder objective with regard to insurers gives the PRA a broader remit which needs to be considered and may require wider debate on the implications of proposed policy changes.
- The PRA’s responsibility for designating Significant Influence Functions (SIFs) would benefit from debate with practitioners.
- The PRA will be the gateway to European and international regulation, and practitioner engagement on negotiating issues could be useful to the PRA.
- The PRA Panel could assist in providing feedback on the practitioner experience of coordination between the two regulators, particularly if it was set up with close links and some common membership with the FCA practitioner panels.

POTENTIAL REMIT REGARDING THE FPC AND BANK OF ENGLAND

The potential for engagement directly or indirectly with the FPC on financial stability issues as they impact on the PRA should also be considered. We believe this is particularly important in respect of the proposed macro-prudential policies. It can be illustrated by considering those in the interim FPC’s first minutes of June 2011. The FPC made several recommendations including specific ones on banks’ forbearance practices and on funding structures such as collateral swaps employed by exchange traded funds. In our view, the assessment of the impact of such policies in advance, but more importantly ensuring the implementation of such policies, would benefit from the expertise and knowledge of practitioners, especially understanding the transmission mechanisms and indirect effects, which will be crucial to their success.

In a speech at the British Bankers’ Association’s Annual Banking Conference on 29 June 2011, Paul Tucker (Deputy Governor for Financial Stability), talked of the broad approach of the PRA. He said that the supervisor will not “... treat firms as islands. They are part of a system. So, at the very least, supervisors will need to look laterally across peer groups of firms for oddities, and stress test firms’ resilience against short-term and longer-fuse threats from the environment. They will, therefore, need to draw on market intelligence on industry trends from the Bank’s Markets area; insights from the operators and overseers of the clearing, settlement and payment systems; and analysis from the finance and monetary researchers in the Bank. Conversely, the Financial Policy Committee will – and already has – drawn on briefings from the supervisors as well as the Bank's existing staff. In other words, this is going to be about making connections, pulling together a varied range of inputs. A measure of the Bank's success when prudential supervision transfers will be how well we knit them together".

We believe that "pulling together a varied range of inputs" is precisely what the FSA Panels have done over the years and that input from a standing body of senior practitioners linked also to the work of the FCA Panels, would contribute to this market intelligence and industry expertise.

ADVANTAGES TO A PRACTITIONER PANEL

We propose a single Practitioner Panel for the PRA – which would also incorporate the views of smaller firms who will be swept into regulation by the PRA. Such a Panel would have the following advantages:

1. Consideration of practical impact of policy changes

The Panel provides an overview from those who will have to implement any policy changes, and if it were also linked to the FCA Panels, would be able to give feedback in the light of FCA policy debates as well. The Panel would be able to review potential areas for misinterpretation of judgement-based regulation requirements on both sides. It would also be able to help the regulator to understand what is required to implement policy proposals successfully, whilst avoiding any unreasonably detrimental impact or unintended consequences on firms, and so assess costs versus benefits in accordance with regulatory principles. The Panel would also be able to look at how prudential requirements interact with conduct requirements from the firms' perspective and the impact on businesses and consumers more widely. We also feel that, adding smaller businesses representation into a PRA Panel would enable discussions about proportionality of application of rules and requirements across different sizes of firm.

2. Ability to review cumulative impact of PRA and FCA on firms

A vital area of concern in the new system is to see that there is effective coordination of regulatory requirements between the PRA and FCA. The PRA Panel should have a strong link to the FCA Panels to enable it to provide commentary and appropriate advice on the coordination of regulatory requirements between the two new regulators.

3. A forum with a remit to help the regulator to look ahead

With a regular forum, the members can look ahead to the impact of regulatory developments and initiate its own enquiries of the regulator if it sees a potentially adverse impact or prudential risk. There is no wish to 'capture' regulators through this system, but to provide forward looking advice on issues to look out for. Decisions on how to use these insights are unambiguously for the regulator alone.

4. Well informed and quality membership

If the Panel is statutory, it is given an authority and credibility which enables CEO level people to be persuaded to give up valuable time to become members. Such individuals are more likely to be able to see the wood for the trees than specialists with a narrower focus. Cross sectoral membership provides a focus on effective regulation rather than the sectoral interests of trade associations, which have a separate and important place in discussions with the regulator (and incidentally seemed to support the role of a standing body of practitioners in some of their comments). The members can sign confidentiality requirements, allowing early debate on the pros and cons of new policy developments. They also build up a knowledge of regulatory policy developments through membership over a period of 3-6 years which helps them to bring regulatory perspective to the debates. In addition, individual and high level advice can be given to the regulator on specific subjects through ad hoc sub groups with Panel chairmen and members outside the formal meeting process.

5. Transparency and public accountability

Although we recognise that the Government has said that the PRA's arrangements for consulting practitioners should be transparent, it will be simpler and more practical for a regular Panel to achieve these transparency requirements: the Panel can be required to produce an annual report (as the FSA Panels do currently) and possibly report to the Treasury Select Committee on the PRA (and FCA) engagement with firms. In addition, the PRA Panel could join the FCA Panel in continuing a similar project to the Practitioner Panel's biennial survey of regulated firms which has proved a useful tool for the FSA and provides feedback on perceptions of the regulator's performance against its objectives.

6. Contribution to EU and international negotiations

Such a Panel could additionally contribute to effective EU and international representation for PRA, by providing a means of facilitating proactive and early involvement of the industry in EU developments. Panel members could provide advice on ensuring that EU rules deliver the desired objectives in as efficient and effective way as possible, such as the precise way in which stress tests are conducted, the different options to increase prudential capital or the interactions between the market structure and payment mechanisms and individual firms. Directives and regulations, even on capital and liquidity matters, include a wide range of specific measures on which industry input is extremely useful to ensure they achieve their intended effect and avoid adverse unintended consequence.

CONCLUSION

We believe that it will be crucial for the PRA to have a statutory standing panel of independent practitioners who regularly engage with the PRA in policy formulation and implementation. The group should have strong links to the FCA Panels. An alternative but less welcome structure would be for the FCA Practitioner Panels to have a remit and responsibility to look at certain prudential issues from the PRA.