THE FINANCIAL SERVICES PRACTITIONER PANEL

RESPONSE TO HM TREASURY CONSULTATION PAPER
'A NEW APPROACH TO FINANCIAL REGULATION: THE BLUEPRINT FOR REFORM' JUNE 2011

06 SEPTEMBER 2011

INTRODUCTION

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.

We would like to start our response with a reiteration of the key points that, from a practitioner point of view, are essential requirements from the regulatory system. Our latest 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.

The most important aspects of regulation are as follows:

1. Clear regulation
Firms need to understand clearly what is expected of them, and for there to be firm and consistent guidance from the regulators on what is required. This is why it is vital that the new UK system is fully joined up, and the new regulators work in an **integrated manner with EU and international initiatives.**

A need for clarity is behind our concern about **judgement led regulation**. We were pleased to see Government support for rigorously evidence-based judgement led decision making in the White Paper. The PRA Approach to Banking Supervision document stated that the PRA will put in place the necessary management and oversight processes to support the judgements required from supervisors and we will continue to engage with the FSA and Bank in their development of the PRA Approach. We urge the Government to continue to emphasise the importance of clarity and consistency in this area.

For the FCA, we are concerned about the wide remit of the FCA, particularly in regard to the **broad definition of consumer** being proposed. We believe this could have a detrimental impact on the operation of wholesale and markets sectors. The FCA must be empowered to make a clear distinction on how it regulates wholesale markets, as too stringent regulation of wholesale and markets risks being counter-productive: it could inadvertently encourage firms to base their wholesale activities in jurisdictions with less stringent regulation, so ultimately undermining the interests of the UK economy and consumers.

On the retail side, the FCA must state more clearly how it will incorporate **consumer responsibility** into its operations. We were disappointed that this was not addressed in the FCA Approach document published in June 2011.

In addition, we believe the FCA should publicly set out its **risk appetite**. The FCA should closely define what type of risk it will be willing to accept, and the type of risk that it will not. This would provide the FCA with a measure of its own performance and allow the FCA to refer to its risk appetite in intervening (or choosing not to intervene) in particular cases.

2. Effective and responsive regulation

The industry is as keen as everyone else for regulators to act firmly and effectively when things start to go wrong: it is the industry as a whole that pays the cost when things go wrong as confidence is undermined, and more directly through payments to the FSCS levy. The recent increase in the levy to provide compensation for the customers of KeyData, has had a significant impact on the bottom line of contributing firms. The FCA will have an increased remit to intervene early, and it must use it to ensure that it acts on issues of detriment in a way that industry can respond to effectively before they reach the size of recent problems with PPI and mortgage endowments.

3. Efficiency and competitiveness

Practitioners recognise that maintaining financial stability has a major role to play in helping firms deliver services efficiently and competitively. However, the cost of regulation in and of itself, as well as the way in which regulatory initiatives impact firms' operations, are also important.

Whilst it is important for the regulators to take strong and effective action, it is also important for them to have an awareness of the impact that their actions may have on the competitiveness of the industry. 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.

4. Coordination

With the adoption of the twin peaks approach, it is crucial that there is effective coordination of action and requests at all levels – from the detailed point of not overlapping on regulatory visits, up to clear coordination of regulatory approaches. Ensuring effective coordination between the regulatory authorities going forward is key. This has also been highlighted by the IMF in their July 2011 United Kingdom Technical Note, where it stated that: "Balancing the enhanced focus of individual authorities with the checks and balances, and coordination needed on an ongoing basis and in a crisis will be key success factors of the new arrangements[1]" and which recognised that: "…there is also a need for cooperation between the PRA and the FCA in the ordinary course of business[2]". The Panel recommends that the proposed coordination measures are supplemented by a statutory duty to coordinate to be included in the regulatory principles. The aim of this would be to ensure that processes are streamlined as much as possible.

Coordination is all the more important for the UK's input into EU policy development. The new UK system does not fit neatly into the European structures, and yet it is vital that the regulators are able to provide comprehensive and coordinated input into all EU (and other international) policy debates.

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[1] P.19, *United Kingdom: The Future of Regulation and Supervision Technical Note – International Monetary Fund Country Report No. 11/230 July 2011*

[2] Dito

5. Cost effectiveness
It is important to have clear disciplines of budgetary control and effective challenge on spending in the new system. There is a danger of duplication of efforts in the two organisations and this must be controlled. The NAO should take an early and proactive part in monitoring the costs of the PRA and FCA.

Already, we are concerned that assurances of aiming for a cost neutral impact after transition costs are looking unlikely. The Panel strongly supports high quality regulation, but would like to emphasise the importance of ensuring value for money in spending and avoiding throwing away existing valuable initiatives in the proposed new structure for regulation.

Engagement with Industry

As we trust that our responses to the debate on regulatory reform have shown, we believe that effective engagement with industry can help to build better and more effective regulation. We remain concerned about the lack of any requirement for a statutory standing body of practitioners in the PRA, similar to that prescribed for the FCA. Key reasons to have a Panel include the Panel's ability to recognise the impact of regulation across sectors, to provide an overview on coordination between the regulatory bodies and to retain 'corporate memory'.

In addition, there must be clear engagement with industry to provide input to FPC decisions. The FPC will have a hugely significant role in the new structure. The macro-prudential instruments that it will be deploying are relatively untested, and yet have not only economic, but often social consequences. The choice of members of the FPC – their experience and balance of interests – is therefore fundamental to the success of this model as they must provide effective challenge of the Bank's view within the FPC. We welcome the Government's decision to continue to consult on FPC membership during the period of pre-legislative scrutiny.

Our detailed responses to the questions posed in the White Paper published in June 2011 follow.

CONSULTATION QUESTIONS

FPC AND BANK OF ENGLAND

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

The Panel supports the Government's continued intention to require the FPC to balance its objective by the condition that its actions should not have a significant adverse impact on the ability of the financial sector to contribute to the UK economy in the medium or long term. However, we continue to urge the Government to strengthen this by requiring that the FPC to have regard to the competitiveness of the UK financial services industry as a whole when exercising their functions. This is discussed further under question 4 below.

We are also concerned to ensure that the FPC considers fully the practical implications of its requirements on the industry. Given the key role played by the FPC in the new regulatory structure, it is vital that the FPC has access to the appropriate expertise and experience of industry, as well as the resources to enable it to fulfil its duties.

This is particularly the case where the FPC has the potential to impact directly on the regulatory requirements on firms. As such, there must be some means of open debate and questioning of the practical implications of these demands. For instance, with reference to the policy recommendations from the first meeting of the Interim FPC in June 2011, the following policy requirements have a significant potential impact on firms:

1. FSA to ensure that improved disclosure of sovereign & banking sector exposures by major UK banks becomes permanent part of reporting framework (and work with FPC to consider further extensions of disclosure in future)
   Firms already provide a huge amount of information to the regulator, and so it is concerning if the FPC can also demand more information in future, which brings associated costs. There should be an opportunity for a dialogue with the FPC as to whether the requests for additional information are necessary – as there is currently through FSA Consultations.
2. FSA to extend its review of forbearance & associated provisioning practices across UK banks' household and corporate sector exposures on a global basis.
   The FPC presumably recognises that this impacts both conduct and prudential regulation. The FPC is leaving the FSA to decide which lenders it is appropriate to proceed with, and it is important that the FPC going forward recognises constraints such as these and does not dictate exactly what regulator must do. For instance, if the FPC suggested the FCA must request firms to amend their conduct and regularly report on management of mortgage forbearance with their customers, firms would not be able to challenge the FCA: the need for such action would be justified by the requirement of the higher level FPC.
3. Advises UK banks that during transition to new Basel II capital requirements, they should take opportunity of periods of strong earnings to build capital so that credit availability is not constrained in periods of stress.
   Here the FPC is issuing advice to banks directly, without going via one of the other regulators who have a duty to consult with industry.

The Panel recognises the importance of ensuring the FPC has access to the right sort of macroeconomic tools. Industry could provide valuable input in the development of these, and we would strongly encourage the regulatory bodies to reach out to Practitioners in developing these instruments.

We also agree with other previous respondents who have argued that the currently proposed FPC membership is overweighted towards the Bank. As such, we welcome the Government's decision to gather views on this issue over the period of pre-legislative scrutiny. We believe that more consideration needs to be given to the balance of membership of the FPC, and its degree of control by the Bank of England. We question why the FPC is proposed to be a sub-committee of the court of directors of the Bank, when the MPC is a separate committee in its own right. It will be important that the FPC provides independent views and challenge to the Bank, PRA and FCA on all their contributions to financial stability.

We are particularly concerned about the power vested in the Governor of the Bank of England under the current proposals According to the proposals, the Governor of the Bank of England will be Chairman of the MPC, the FPC and the PRA, in addition to having the role of sitting on the FCA board and maintaining oversight of the bank resolution regime. There are strong views in the industry that such a large concentration of power in one individual in one organisation is a cause of concern and arguably an over-reaction to the criticisms of the previous tripartite regime. The Panel strongly believes that there needs to be greater clarity on this subject, and as such welcomes the ongoing investigations by the TSC into the accountability of the future Bank of England as a regulator as well as that of the FCA.

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

We note the Government's decision to move the regulation of RCHs to the Bank of England; however, we are concerned about the implications for vital European regulatory developments and associated negotiations. Under these proposals, effective representation of RCHs in debates in Europe could be undermined, as the FCA (and not the Bank) will be responsible for representing markets and CCPs at ESMA. This is despite ESMA being responsible for such things as the drafting the technical standards under EMIR. It will be vital, at the very least, for the proposed statutory MoUs to cover RCH representation via the Bank.

We also question whether the new Bill needs to confer new powers on the Bank to impose disciplinary measures on RCHs, particularly as there is no evidence of market failure being attributable to the actions of RCHs and RIEs. Notwithstanding that, we believe that if such powers are to be imposed, adequate checks and balances must be put in place that are **at least equivalent** to those that currently exist for those firms authorised under Part IV of FSMA.

3. **Do you have any comments on:**
   a. **The proposed crisis management arrangements; and**
   b. **The Proposals for minor and technical changes to the Special Resolution regime**

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

Although we are pleased to see a clear authority and responsibility for crisis management action in the event of a future crisis, we remain concerned about the amount of power and responsibility vested in the Governor of the Bank of England. We question whether giving a single person so many different roles is the best answer to the coordination problems exposed in the last crisis. As noted in our answer to Q1, the Governor will have a large number of extremely significant roles in the new structure. In relation to crisis management, the Governor also has a significant role in the Special Resolution Regime, and there is a potential for conflict in these two roles.

We would ask the Government to consider if greater scrutiny of the role of the Bank of England is necessary in order to be assured that all the roles of the Governor can be carried out effectively.

PRUDENTIAL REGULATION AUTHORITY (PRA)

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

The Panel strongly believes that the regulators should have a specific requirement to consider competitiveness in its own right. We therefore disagree with paragraph 2.51, which states that financial stability, supported by a rigorous and effective regulatory framework provides a strong platform for industry growth, which will in turn foster a competitive industry. In our view, this is necessary but not a sufficient condition for arriving at the appropriate regulatory stance. We believe that competitiveness and financial stability are complementary goals and not competing ones. However, a lack of regard of regulatory actions on the relative competitive impact on our industry could increase firms' costs unnecessarily, and in the extreme, could even encourage firms to locate more of their operations abroad and could have significant long term implications for the presence of London as a financial centre. Given the contribution made by the British financial sector to the UK economy as a whole, we regard the inclusion of competitiveness as key.

A strong regulator with regard to competitiveness (as well as proportionality) should lead to a reasonable and not overbearing level of regulation by the PRA. This will be important for all, because if it becomes considerably more expensive or cumbersome for firms to conduct their operations in the UK, they may consider moving all or part to countries where regulation is significantly less demanding, and attempt to sell in products and services. This is not in the interest of the UK economy, consumers or firms.

We support the Government's commitment to a flexible approach in the objectives of the PRA in order to allow the PRA to focus on the specific needs of particular firms. The new recognition in the objectives that the insurance sector is significantly different from the banking sector in nature is welcomed. However, this brings a very different skill requirement into the PRA in considering the needs of consumers. The Government has included a recognition that the PRA will need to consult with the FCA in this area, and so it remains unclear what the 'policyholder protection' objective means in practice for the PRA, and we look forward to seeing greater detail on this area as the Bill is debated.

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

The Panel has supported the development of judgement-led supervision, only if there are strong systems in place to ensure that the decisions are made according to recognised principles and are consistent over time. We were pleased to see that in the PRA Approach to Banking Supervision document published in May 2011, it stated that the PRA will put in place the necessary management and oversight processes to support the judgements required from supervisors in its approach. The Panel would welcome greater detail on how these processes will be developed and approved, and believes it would be helpful for the FSA/PRA to consult on these.

There must also be clear mechanisms for challenging outcomes under this approach. We note that the Government is now proposing to leave the Tribunal's scope of review of supervisory decisions unchanged. However, we remain concerned about the curtailment of the Tribunal's powers if it chooses not to uphold the relevant regulator's decision. We believe that the Tribunal provides an important check and balance on the regulator. We would like to see it retain all its powers, or if not , for the PRA to have to report back and gain approval from the Tribunal on how it proposes to reconsider matters rejected by the Tribunal in the light of the Tribunal's findings.

We also continue to believe that there should be the development of an informal and confidential appeal process in the regulators going forward which would be a mechanism for judgement-led supervision to be challenged, and which would contribute to ensuring greater consistency across regulatory judgements and cases.

We continue to believe that there should be a statutory Practitioner Panel for the PRA, as well as for the FCA. This was also recognised by the majority of respondents to the last consultation. As stated on page 377 of *'A New Approach to Financial Regulation: the Blueprint for Reform'*, 'almost all respondents [to the February consultation] argued that the PRA should retain the Practitioner Panel in its current form'. A detailed paper on the arguments for a statutory body is at Appendix 2 of this response. The three key advantages are listed below:

a) A statutory standing body of practitioners representing the wider industry would be able to *recognise the impact of regulation in one sector on another*. Specialist ad hoc groups drawn together for e.g. the purposes of giving input on regulation in the mortgage market would not appreciate the potential impact that same regulation could have in other sectors.
b) A standing body could comment on and therefore contribute to more effective *coordination between different regulatory bodies*. It could monitor how successfully they coordinate and provide feedback on an ongoing basis. This would work best with a Panel that has some overlapping membership or coordination requirements with the FCA practitioner panels.

c) A statutory standing body of practitioners would have a '*corporate memory*' and so recognise links and repetitions over time that may not be obvious to ad hoc working groups.

The FCA Approach document published in June 2011 has recognised that specific engagement with industry can be a valuable tool in improving the quality of regulation. The PRA Approach to Banking Supervision makes clear that despite increasing regulatory initiatives being created at an EU level, the Bank of England and the FSA expect the PRA to be involved in policymaking in a range of areas. As such, we believe it would benefit from the expertise of a statutory standing body of Practitioners in assessing the impact of proposed new regulation and advice on industry and consumers.

The most important aspect of such a PRA Practitioner Panel would be to consider and advise on the most effective way for the PRA to implement regulation. For the avoidance of doubt on this matter, we would stress that this is not an accountability of regulators point, but an engagement point. Therefore, we would like to suggest that the wording of new sections 2J (2) and 2K (1) are amended as follows, with insertions flagged in bold type:

2J The PRA's general duty to consult
(2) Those arrangements ~~may~~ ***should*** *include the establishment of ~~such panels as the PRA thinks fit~~* ***a Practitioner Panel to provide a regular forum for policy debate with a cross section of senior representatives of those firms regulated by the PRA and to consider the cumulative impact of regulation by the PRA and FCA on firms.***

2K Duty to consider representations
(1) The PRA must consider representations that are made to it in accordance with arrangements made under section 2J, ***but the PRA will not be accountable to practitioners for its decisions having considered the representations.***

FINANCIAL CONDUCT AUTHORITY (FCA)

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

In theory, the overall strategic objective and operational objectives of the FCA seem sensible and we support the thrust of the Government's proposals. However, we have grown increasingly concerned about how these overall objectives will be interpreted.

The White Paper points to more detail being made available in the FCA Approach document, published in June. Although much of that document sets out a balance approach, we were somewhat concerned at the tone of conference that the FSA held to launch that document. 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. Having made this point, we appreciate that there was only a short time period for the FCA Approach conference to be developed and that the new FCA Chief Executive has only started work this month.

The FSA has said[3] 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 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 exisisting conduct initiatives, for example, around Treating Customers Fairly should mean that the proposed product intervention and a more proactive approach to regulation will result in less, not more, enforcement cases. If the FCA interprets its objectives in this way, there is a real danger that the FCA will undermine rather than enhance confidence in the UK financial system..

We would appreciate further commitment from the Government 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.

One area that we believe needs further emphasis and clarification is in the inclusion of consumer responsibility as a key principle of 'have regard' for the regulator. We were disappointed that there was no discussion of how the FCA will carry forward this responsibility in the FCA Approach document published in June. 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.

The Panel is concerned that a 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. As a Panel, we have often challenged the FSA on a tendency towards "one size fits all" regulation. We are concerned that this universal definition of consumer will further encourage such an approach.

We are generally supportive of the proposed competition powers, although we are concerned about price intervention powers for the FCA. 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.

We continue to maintain that the regulators should each have the duty to coordinate set in their regulatory principles. Although there is an overall statutory duty, we believe it is the

[3] FCA Approach, published by the FSA June 2011 pages 7 and 25.

objectives and principles which will be used to guide the day to day operations of the regulators. An example of this is in the FCA Approach document, published in June – this considers how the FCA will approach its objectives and the regulatory principles, but does not consider the statutory duty to coordinate.

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

The new product intervention powers being proposed for the FCA should be considered as just one of the range of tools which the regulator will have at its disposal in achieving its objectives. We 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 which is subsequently proven to be unsafe, or 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.

We are concerned that product intervention 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, this should not risk the FCA deciding to discard all the investment that the industry has made in previous regulatory initiatives such as Treating Customers Fairly(TCF). 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.

In terms of ensuring value for the money, the Panel recognises the increased costs of keeping a large number of firms relationship-managed moving forward, but believes relationship management can be a key component of effective regulation. We do not believe that 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, will lead to an improvement in 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.

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. 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.[4] 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.

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[4] Financial Services Practitioner Panel Sixth Survey of the FSA's Regulatory Performance, February 2011.

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 White Paper states that the FCA will have a 'lower risk threshold for potential consumer detriment'. In order to assess its own effectiveness over the longer term, the regulator will need to more closely define 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. It would also 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 clear 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.

We 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 nevertheless are 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 .

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.

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

The Panel is supportive of the intentions behind allowing nominated parties to refer to the FCA issues causing mass detriment, and can see advantages to both consumers and industry in having a set system in referring issues that have been identified as causing consumer detriment in the market.

We would be interested in exploring this further, particularly as it is suggested that the FCA Panels may have a role here. We would be interested in engaging in further discussion on whether this would be an appropriate form of whistle blowing from the Practitioner Panels if they felt that the regulator was not taking appropriate action in areas of potential or actual consumer detriment.

However, it is key that any consumer redress powers are implemented in the right way. The FCA must have robust processes in place to ensure that referrals from nominated parties are dealt with fairly according to set criteria, transparently and that there is an informal mechanism for appeal for firms. From a resource perspective, it will also be vital for the FCA's own efficiency and effectiveness that it has clear systems and criteria in place to deal with referrals, in order not to get overwhelmed by requirements to look into a large number of complex products in minutiae. It is also important to consider how the FCA might measure detriment, as potential detriment may be difficult to assess and vary at different points in a product's life cycle.

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

The Panel supports this proposal subject to the caveats highlighted in question 8. As in the discussion on warning notices (see question 14), it would oppose any proposal to prejudice ongoing specific investigations.

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

The Panel supports the competition powers currently proposed for the FCA. Giving the FCA powers to refer competition matters to the OFT where appropriate seems sensible. The Panel agrees with the decision not to provide FCA with concurrent competition powers, as we believe this could raise concerns around duplication and coordination between multiple regulatory competition authorities.

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

We welcome that the listing authority will remain within the FCA. However, we are concerned that the listing authority will come under the general framework of the FCA - and therefore lose its requirement to have regard to the international competitiveness of the UK. We suggest that either the listing authority retains its separate framework and objectives, or the FCA should have a fourth operational objective to "have regard to the relative attractiveness of the UK's markets" (as a replacement for "competitiveness"). We believe that the UK could be put at a serious competitive disadvantage to other global financial centres if this is not done.

We welcome the Government's decision not to proceed with its original plans to dismantle the tailored regime for regulating exchanges and CCPs ("Recognised Bodies") and instead to carry forward the Recognised Body regime in the Financial Services Bill. The structure of the current regime is correct in recognising, and continuing to recognise, the unique position of Recognised Bodies as front-line regulators of the member firms which use their facilities. As such, the Recognised Bodies are partners in regulation with the FSA and have provided an effective framework for the maintenance of fair and orderly markets.

It is important to remember that this regime proved effective during the financial crisis. No Recognised Body was in distress – or in receipt of government funding – during the period of financial turmoil. On the contrary, the Recognised Bodies played an important part in managing the consequences of the default of major financial institutions, such as Lehman Brothers; and their markets continued to operate effectively and in an orderly and transparent manner, whilst liquidity in many other fora dried up.

The legislative framework in most jurisdictions with major financial centres distinguishes exchanges and clearing houses on the one hand from users of their facilities (e.g. investment firms and banks) on the other, and subjects them to appropriately tailored regulatory obligations. Subjecting exchanges and clearing houses in the UK to a regime designed for investment firms and banks would have run counter to those established international standards and would have raised a question mark over the continued ability of UK-based exchanges and clearing houses to provide their facilities to their many users based outside the UK.

Whilst we therefore welcome the Government's decision to retain the Recognised Body regime, we also note that the Financial Services Bill includes amendments to the regime (e.g. powers to fine and publicly censure Recognised Bodies, increased rule making powers and changes to the existing power of direction over Recognised Bodies). Such changes could, depending upon how they are operated in practice, radically alter the nature of the cooperative relationship between Recognised Bodies and the statutory regulator, whereby the statutory regulator and the Recognised Bodies are currently partners in regulation.   Changing the nature of the relationship between the statutory regulator and Recognised Bodies could prove to be counterproductive if it were to undermine the ability of the statutory regulator and the Recognised Bodies to work together effectively – making use of their respective knowledge, powers and regulatory reach - in the interests of the efficacy of the regulatory system as a whole.

We therefore do not see the justification in the proposals both to simplify the process for issuing directions to RIEs, and also making it easier for the FCA to abbreviate the process altogether. It is not reasonable to do both, and suggest that if there is a change to allow a shorter process, then the rest should be retained as currently worded in s.296 and 298 of FSMA.

We also do not believe that the FCA being given new powers to impose disciplinary measures on RIEs, including public censure and financial penalties is justified. As with RCHs (Question 2), we do not support this, and we do not see what failures have occurred that would justify this increase in power. If the powers must be introduced, they must come with adequate checks and balances that are **at least equivalent** to those that currently exist for those firms authorised under Part IV of FSMA.

We also do not see any historic justification or evidence of market failure that would support the proposal to allow the FCA to request Skilled Person Reports (s166 reports) from both RIEs and listed issuers. The Government must be careful not to over-burden the UK's wholesale markets in comparison with other competitors in the global arena.

In conclusion, the Financial Services Bill must avoid undermining the basis on which legitimate business is conducted today. There is a danger that technical modifications to the current FSMA regime will inadvertently remove the legal basis for some of this business. For example, as a consequence of moving from a unitary regulator to a "twin peaks" regime, the Financial Services Bill would remove the FSMA provision (section 285(2)(b)) under which exchanges currently operate "cleared only" services. The legal basis for the future operation of such services is therefore unclear as a result of the Financial Services Bill (e.g. whether such services can continue to be operated by an exchange or whether they can only be operated by an entity which has CCP status).   Clarification is needed before the Financial

Services Bill enters the legislative process in order to avoid damaging unintended consequences.

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

The Panel welcomes the proposed statutory roles of the four Panels going forward under FCA. It further believes this could be complemented not only be statutory Practitioner Panel representation in the PRA (see answer to question 5), but also a Practitioner Advisory Body to look across the FCA, PRA and the FPC. This would comment even more effectively on the coordination between the regulatory bodies and pick up read-across from regulation in the prudential, conduct and macro-economic areas.

The Panel welcomes transparency in the regulatory bodies, and is happy to publish its minutes for the purposes of transparency.

PROCESSES

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

The Panel is fully supportive of the proposed duty for the FCA and PRA to ensure co-ordinated exercise of functions in FSMA going forward, as well as the references to the need for each regulator to use their resources in the most efficient and economic way, ensuring that burden and restrictions that are imposed are proportionate to the benefits. It is vital that the UK is able to present a united front in European negotiations, and this will need a coordinated effort, as the split of UK regulators is not mirrored in the European structures,

We support the requirement for the two authorities to publish a MoU on the topic of coordination, as well as the new requirement that the PRA and FCA must include in their annual report an account of how they have coordinated during the year. We suggest that this could be strengthened by a requirement to include, or respond to commentary from, the Independent Panels (both Practitioner and Consumer) on their views as to whether coordination is effective, and any problems that have been identified over the year.

In addition, given the importance of ensuring effective coordination between the two authorities going forward, the Panel believes that there need to be further provision for joint working on a day-to-day level. The Panel recommends that the proposed coordination measures are supplemented by a statutory duty to coordinate to be included in the regulatory principles. The aim of this would be to ensure that processes are streamlined as much as possible. We strongly welcome proposals to streamline such processes in relation to firm authorisation and individual approval, and believe that similar coordination should also be extended to processes in the areas of handbooks, assessment of firms' systems and controls, and assessment of firms' business models.

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

The Panel strongly supports any proposal that is aimed at reducing any conflicting requirements coming from the two regulators in future. Therefore, we support the new proposal for the PRA to lead on firm authorisation for dual regulated firms, and plans to align the timetable of authorisation of a new firm and approval of persons conducting controlled functions in that firm for efficiency reasons. The Panel further welcomes the requirement for the regulators to consult each other before making new rules in order to ensure that each is aware of the potential prudential/conduct implications of such rules.

The Panel does however 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).

COMPENSATION, DISPUTE RESOLUTION AND FINANCIAL EDUCATION

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

Although we support the continuation of the overall operating model for FSCS, we are concerned that the funding requirements for FSCS have the potential to cause systemic risks for certain sectors of the industry which are called on to fund significant levies. We believe that 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. The FSA is due to review FSCS funding once EU plans for compensation are clearer. This review will be significant, and key lessons need to be learned and taken on board from previous regulatory failure (including KeyData and PPI) by the new regulators.

In terms of Financial Education, the Panel has highlighted the lack of cost control on the set up of the Money Advice Service with the FSA. 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. As the funding will be from industry, we believe there must be public discussion of the costs and benefits of the Money Advice Service. This should be made much clearer in this new legislation.

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

* Member 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.