THE FINANCIAL SERVICES PRACTITIONER PANEL

RESPONSE TO HM TREASURY CONSULTATION PAPER
'A NEW APPROACH TO FINANCIAL REGULATION: BUILDING A STRONGER SYSTEM' FEBRUARY 2011

14 APRIL 2011

INTRODUCTION

The Financial Services Practitioner Panel has a statutory duty to represent the interests of regulated firms as a whole with the Financial Services Authority (FSA). More details of our role, remit and membership are at Appendix 1. Whilst individual trade associations will provide more detail on specific points on this consultation, the Practitioner Panel's focus in this response is to provide feedback to help to develop a regulatory system which works in the best possible way overall for both regulators and firms: we share a common interest in achieving effective regulation of financial services in the UK. As such, we have answered only the questions in the consultation where we have some specific points to make.

We welcome the progress that has been made since the previous consultation in providing greater detail on how the Government plans to achieve its overall aims. This consultation has a much greater appreciation of practical requirements of a fair regulator from industry's point of view. We are particularly pleased that the name of Financial Conduct Authority has been adopted. The previous name of the Consumer Protection and Markets Authority, which was linked with the role of 'consumer champion', whilst having a helpful reference to markets, promoted an inappropriate role for what should be an impartial regulator. This move, together with the recognition of the need for consumer responsibility in the objectives, has restored balance into the perception and objectives of the conduct regulator.

We are also pleased to see a much greater emphasis on the need for coordination in this consultation: coordination is vital, both in the new UK regulatory system, and in order to ensure effective linkages with international and EU requirements. Although we believe there are still more aspects to be considered, we welcome fact that the importance of coordination clearly recognised in this document.

The main themes where we believe that further work is needed are as follows:

1. **Need for structured mechanisms for engagement with firms throughout the regulatory system**
   Structured engagement with firms is needed at the PRA and across the regulatory system as well as at the FCA. It would be much more effective for the PRA to have a Practitioner Panel which met regularly to engage, rather than a vague commitment at the full discretion of the regulator to consult, as set out in the consultation. Such a Panel would provide a focus for a group of senior executives to have an ongoing commitment to look at the impact of regulatory policy in the UK, and to provide support for PRA negotiations at EU and international level. Such a formal body could publish an annual report, and possibly report to the Treasury Select Committee and so more easily fit with the Government's wish for transparency and public accountability across the system.

   We believe that the proposed Markets Panel will provide a useful and focused forum for debate on the markets and wholesale aspects of the FCA's remit. However, we believe that the Markets Panel should also be given the means to link across to ask questions of the systemic infrastructure regulation which will be transferred to the Bank of England.

We also believe that if the Government is serious in its commitment to regulatory coordination, cost effectiveness and mitigation of the risk of duplication, then it should allow a formal system of feedback from the firms which are at the receiving end of dual regulation. A Practitioner Advisory Panel – consisting of representatives from the PRA and FCA Practitioner Panels, SBPP and Markets Panel could provide feedback and debate across the regulatory system.

2. **Importance of effective coordination between regulators**
We appreciate the commitment to coordination in the consultation, but we remain concerned about how cumbersome the process will be in practice. To help to address this, we recommend that the statutory duty to coordinate should also be enshrined in the regulatory principles, and processes should be shared and streamlined as much as possible. We also believe it will be important to have a forum for firms' feedback on the coordination via the Practitioner Advisory Panel as set out in point 1 above.

3. **Judgement led regulation must be consistent**
We fully support the proposal for regulators to work intelligently and use their judgement. However, the PRA will need to ensure quality and consistency of regulatory approach from different supervisors. There should also be some mechanism of informal and confidential appeal or escalation process for firms within the PRA, as interim step rather than full judicial review. The PRA will be taking decisions which may have a fundamental impact on a firm's business plan – there should be an ability for firms to challenge those decisions without going through a full legal process.

4. **The FCA must highlight different aspects to its remit**
There must be clarity in the legislation and activities of the FCA going forward to ensure a different approach to wholesale and markets regulation compared to retail regulation.

   In addition, although much is made of the FCA as a conduct regulator, it must not be forgotten that the FCA will also take on the prudential regulation for the majority of firms. Ensuring the financial soundness of firms is vital to confidence in financial services. Therefore there must not be a simplistic distinction made between the regulators that the PRA undertakes prudential regulation and the FCA supervises only conduct.

5. **Liabilities in product intervention power for FCA**
The powers of product intervention for the FCA need to be clearly delineated. It could result in some significant potential liabilities. This is an area where many complex products are suitable when only sold to certain categories of people. The problems occur when the selling of the product extends to a wider range of people. We question the responsibilities of regulator towards costs incurred by firms when it bans a product which is subsequently agreed is safe. In the opposite situation, the regulator could become liable for consumer losses if a product is not banned which is subsequently found to have caused problems.

6. **Role and remit of the FPC**
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 – as in the recent debate around levers to be used for the FSA's Mortgage Market Review. The choice of members of the FPC – their experience and balance of interests – is therefore fundamental to the success of this model. The members must also be provided with the resources to enable them to devote time to getting out and about and engaging with a wide range of people and organisations to investigate the possible consequences of their decisions, as well as considering the technicalities of policy options.

7. Impact of external factors

Although there is some reference to this in the consultation paper, we would like to emphasise again how important it is to recognise that these changes in the UK system of regulation are taking place on shifting sands of international and EU regulatory systems. The Government must remain alive to the implications of changing regulatory requirements which will also have an impact on firms.

CONSULTATION QUESTIONS

BANK OF ENGLAND AND FPC

1. What are your views on the likely effectiveness and impact of these instruments as macro-prudential tools?

The Government's decision to establish the detailed macro-prudential toolkit in secondary legislation provides welcome flexibility in being able to adapt the toolkit in response to international and European agreements. This is particularly important as the Panel is concerned about how macro-prudential tools can be effective if applied just to the UK: it will be important for the UK to be able to act in concert with other countries in reducing the impact of any future crises. On the other hand, it will also be important for the FPC to be able to deal with the different points in the economic cycle reached by the UK and other countries.

At this stage it is difficult to tell the likely effectiveness and impact of the instruments described in the consultation paper. Much will depend on the circumstances in which they are used, and the combination of different tools used. We remain concerned that many of the tools which are being discussed are relatively unproven and might have unintended adverse consequences. We also believe that the interaction of macro-prudential and micro-prudential tools will be very important. In this regard, the behaviour of economic agents (individual companies and firms) will need to be taken into account.

We acknowledge the importance of the FPC having a strong and clear mandate in protecting and enhancing the resilience of the financial system, and so contributing to financial stability. However, we agree with the Treasury Select Committee's point that the objective of enhancing financial stability might sometimes involve trade-offs with certain other policy objectives such as economic growth and potentially inflation targets. The additional factors listed of proportionality, openness and international law are reasonable to add. However, we also believe that the social consequences of FPC actions may need to be taken into account.

The recent experience with the FSA's development of the Mortgage Market Review is a case in point. The initial Cost Benefit Analysis (CBA) by the FSA looked purely at the economic criteria for restricting the mortgage market in certain ways. After substantial comments from both industry and consumer representatives, the FSA has acknowledged that a broader CBA needs to be undertaken before taking action in the mortgage market. This is a clear example of where actions taken to control stability in the markets could ultimately affect house prices and so have significant ramifications not only on the economy, but on the broader social agenda. This broader agenda and the transmission mechanisms via individual firms, must at least be considered by the members of the FPC when deciding on the use of different macro-economic tools.

3. Do you have any general comments on the proposed role, governance and accountability mechanisms of the FPC?

We believe that point 4 of the FPC's objective is unnecessarily negative. Instead of: "This does not require or authorise the Committee to exercise its functions in a way that would in its opinion be likely to have a significant adverse effect on the capacity of the

financial sector to contribute to the growth of the UK economy in the medium or long term."
We suggest the objective could be written more positively, such as:
"The Committee should look to exercise its functions in a way that would in its opinion not be likely to have a significant adverse effect on the capacity of the financial sector to contribute to the growth of the UK economy in the medium or long term."
Or even:
"The Committee should look to exercise its functions in a way that would in its opinion help the financial sector to contribute to the growth of the UK economy in the medium or long term."

We continue to be concerned about the balance of membership on the FPC. This is particularly the case with regard to the need for the FPC to understand how their decisions will impact upon the firms which will need to implement the changes. We note that the independent members of the Interim FPC as listed in this consultation, do not have deep and recent experience of running a financial services firm. We urge the Government to ensure that in the permanent FPC and going forward, there should be a direct commitment to deeper commercial financial services experience, such as to specify that at least one member has been an executive director of a financial services firm in the last 5 years.

We believe that is will also be important for FPC members to have current experience of how their measures are being translated into everyday life. There should be a clear responsibility on FPC members to travel the UK and internationally, and to engage with stakeholders, including all types of financial services firms, to ensure that they are alert to the consequences of the decisions that they are taking.

We also question the dominance of membership of the FPC by the Bank and the role of the Governor in chairing the FPC, PRA, Bank and other bodies such as the MPC. Although we appreciate the desire for coordination through this model, we question the potential conflicting objectives and other conflicts of interest inherent in this structure. Not only are we concerned about conflicts, but also the capacity for a single person to hold so many significant roles effectively.

We believe there is also a danger of the chief executive of the FCA being relatively isolated in his focus on the translation of FPC decisions on to FCA-regulated firms. There will be a significant number of firms which will only be regulated by the FCA, and so we suggest there should possibly be another independent member of the FPC who is also at least a member of the FCA Board and has FCA interests at heart.

The checks and balances set out for accountability of the FPC's use of the power of direction are well argued in this consultation, although we remain concerned that the Treasury has the power to 'switch off' or modify the requirements for the regulators to consult or look at costs and benefits in these cases. As we have raised above, the current Interim FPC has relatively little direct industry experience. We would like to be assured that there would be some requirement for the FPC to consider the practicalities of the effectiveness of its measures before implementing any Direction.

The accountabilities around the FPC's power of recommendation have far fewer checks and balances than the direction, and yet may be almost as powerful. Our view is that individual firms, and possibly the PRA and FCA, are, in most cases, unlikely to want to

object to the FPC's recommendation other than in exceptional circumstances. This is particularly the case for the PRA, as both the FPC and the PRA are chaired by the Governor of the Bank of England. Therefore the FPC is likely to have almost the power of direction through its recommendation, without the surrounding accountabilities or industry consultation responsibilities.

4. Do you have any comments on the proposals for the regulation systemically important infrastructure?

The arguments set out for moving the regulation of systemically important infrastructure to the Bank of England seem to be reasonable. We also support the proposal to await the changes to be required through the European Markets Infrastructure Regulation (EMIR).

Our comment on this question focuses on the fact that the split between the Bank and FCA in the regulation of markets introduces a weakness in the 'twin peaks' system as designed. In addition to the coordination measures proposed in the consultation and our recommendation in respect of Q10 and Q12 below, we advocate that the new FCA Markets Panel should also represent the interests of those firms covered by the systemic infrastructure of the Bank. The Panel should then also be given powers to engage with the Bank in this area, possibly through a similar power as that given to the current FSA Panels in Section 11 of FSMA[1].

PRUDENTIAL REGULATORY AUTHORITY

5. What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the PRA?

The strategic and operational objectives for the PRA seem to be sound and reflect the aims of the Government in focusing prudential regulation on financial stability. We are pleased to see a recognition within the text of the consultation that much of the detail of prudential regulation will be directed by the European regulatory bodies. It may be worth considering the incorporation of a need to work in collaboration with the European regulatory bodies into the objectives of the PRA.

We welcome the proposal for both regulators to share the same regulatory principles as set out in Box 3.B.

However we recommend that coordination between the regulators is added to those regulatory principles. We appreciate that a statutory duty to coordinate will be introduced, and that high level cross-representation on Boards and other safeguards will be put in place. However, we believe that coordination with the other regulator where relevant should also be enshrined in the regulatory principles. This would provide an ongoing and explicit impetus for coordination at a working level within the PRA and FCA.

[1] Financial Services and Markets Act 2000 – Section 11 **Duty to consider representations by the Panels**. (1)This section applies to a representation made, in accordance with arrangements made under section 8, by the Practitioner Panel or by the Consumer Panel. (2)The Authority must consider the representation. (3)If the Authority disagrees with a view expressed, or proposal made, in the representation, it must give the Panel a statement in writing of its reasons for disagreeing.

We will be looking for particular emphasis on the second regulatory principle which requires both the regulators to abide by the principle that a burden or restriction imposed should be proportionate to the benefits. We have not always been convinced that the FSA has kept to this principle when it has wanted to apply new regulations. In our last annual report, we highlighted examples of where the FSA has introduced changes where the Cost Benefit Analysis (CBA) has not supported the case for implementation – such as with the publication of complaints data. There have also been initiatives such as Treating Customers Fairly where a CBA was not carried out, even when significant changes were required of firms. We have continued to highlight the need for full assessments of the costs versus benefits in the FSA's development of the Mortgage Market Review and Retail Distribution Review.

In the current proposals, we also welcome the introduction of a clear regulatory principle that consumers should take responsibility for their decisions, and with that, the recognition that the regulator and firms cannot take all the burden of responsibility away from the individual consumer.

6. What are your views on the scope proposed for the PRA, including Lloyd's, and the allocation mechanism and procedural safeguards for firms conducting the 'dealing in investments as principal' regulated activity?

The proposed scope for the PRA seems reasonable in the context of the priorities that the Government has set out.

We would like to emphasise how important it is to develop a regulatory regime which is sensitive to the different character of different parts of the financial services industry. It is something which the Practitioner Panel has highlighted with the FSA on a number of occasions. It is often not appropriate, and can be damaging to 'read across' regulations which have been successful in one part of the industry, into a possibly very different sector of the industry.

We are therefore to a certain extent reassured by the inclusion of this - 'The Government, the Bank of England, and the FSA will continue to consider how the characteristics of insurance firms should be recognised appropriately within the regulatory framework' (3.22). On the other hand, it is somewhat disturbing that the FSA and the Bank of England are seemingly unclear on how to deal with the different requirements of insurance companies.

We recognise that it is reasonable to give the PRA the power to increase the scope of the PRA regulation to designate certain investment firms for prudential regulation by the PRA where it determines they could pose significant risks to the stability of the financial system, or to one or more PRA-regulated entities within their group. We are satisfied that there seem to be significant safeguards around this process.

We also believe that it is right that the FPC should advise the Treasury on any changes to the overall perimeter of regulation, although theirs should not be an exclusive right to advise the Treasury on the perimeter of regulation.

7. What are your views on the mechanisms proposed to make the regulator judgement-led, particularly regarding: rule-making; authorisation; approved persons; and enforcement (including hearing appeals against some decisions on a more limited grounds for appeal)?

We are fully supportive of the regulator being judgement led. However, this can only be on the basis of clear and agreed principles which are consistently applied. We welcome the step towards this in the current consultation, with the requirement for the PRA to include short statements of purpose in relation to the rules to allow firms more access to the rationale behind the rules. However, as we said in our previous response, the principles that they are judging against must be clear. The proposal in this consultation for rules to be set out with principles behind is a step in the right direction.

Nevertheless, it will be important to ensure that there are processes in place to allow robust debate on the judgements taken by the regulator, which stop short of formal enforcement or judicial review processes. We would like to suggest an interim review stage, beyond debate with a firm's supervisor, but before the 'nuclear option' of a full public review process.

For the enforcement process at the PRA, we believe that the FSA's current Regulatory Decisions Committee provides an extremely useful forum for debate on the enforcement decisions of the FSA. A similar body should exist to mediate on the debates between the PRA and regulated firms.

We believe that it would be unfair not to allow a full appeal beyond this stage. In our opinion, appeal will be all the more necessary in the case of judgements being taken by the PRA. We would hope that if the interim stages suggested above were introduced, they would lessen the necessity for appeal, but the right of appeal must not be taken away.

8. What are your views on the proposed governance framework for the PRA and its relationship with the Bank of England?

The overall governance framework proposed appears sound. We are pleased to see that the PRA's status as operationally independent of the Bank of England will be supported by a strong independent Board with a majority of non-executives whose appointment should be approved by HM Treasury. The Board is also due to be bound by principles of good corporate governance.

We do have some degree of concern as expressed earlier in answer to Q3, about the wide range of roles for the Governor – both in terms of conflicts, and also in the capacity for a single person to hold so many significant roles effectively.

We are also unconvinced by the degree of external challenge to the PRA on its budget, value for money and performance against objectives. The consultation document proposes that the PRA will only be accountable to the Court of Directors of the Bank of England for these administrative matters. We would like to suggest that there is some opportunity for wider debate on these subjects. As it stands, the funding will be supplied by the industry and yet there will be no means of the industry getting its voice heard if there are concerns about value for money in the operations of the PRA. We would like to see some opportunity for dialogue with the industry through the practitioner representation

as suggested in our answer to Question 10, or at least some wider accountability on the PRA's budget to the Treasury or Treasury Select Committee.

9. What are your views on the accountability mechanisms proposed for the PRA?

The proposed accountability mechanisms for the PRA to Ministers and Parliament, and to the public appear to be sound.

10. What are your views on the Government's proposed mechanisms for the PRA's engagement with industry and the wider public?

The Government and the Bank of England have made it clear that the regulators should only be accountable to Parliament, and not to the industry it regulates. We agree that we do not see the regulators as answerable to the industry in what they seek to achieve. However, engagement with the industry at an early stage of policy development has significant benefits for regulators as well as firms. We believe that this should be incorporated into the set up of the PRA as well as the FCA.

We believe there are significant benefits to establishing a mechanism for structured and ongoing liaison between the PRA and firms. We have developed a detailed paper on the subject, which is at Appendix 2.

We believe a statutory Panel or similar structure would provide:

Structured forum for engagement

- a forum for debate to help the regulator to understand what is required to successfully implement policy proposals whilst avoiding any unreasonably detrimental impact on firms; consideration of costs versus benefits in accordance with regulatory principles; any potential for misinterpretation of judgement-based regulation requirements on both sides; how prudential interacts with conduct requirements from the firms' perspective; and the impact on businesses and consumers more widely;
- early, pre-publication engagement with industry, as Panel members can be signed up to confidentiality requirements, allowing early debate on the pros and cons of new policy developments;
- A forum for practitioners to 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 – the regulators do not have to follow the advice, but should consider it (the current section 11 power[2]);

[2] Financial Services and Markets Act 2000 – Section 11 **Duty to consider representations by the Panels**. (1)This section applies to a representation made, in accordance with arrangements made under section 8, by the Practitioner Panel or by the Consumer Panel. (2)The Authority must consider the representation. (3)If the Authority disagrees with a view expressed, or proposal made, in the representation, it must give the Panel a statement in writing of its reasons for disagreeing.

Contribution to EU and international negotiations

- Contribution to effective EU and international representation for PRA, with a means of facilitating proactive and early involvement of the industry in EU developments;
- Advice on ensuring that EU rules deliver the desired objectives in as efficient and effective way as possible eg 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;

Well informed and quality membership

- High level membership – usually CEO level. 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. Members serve 3-6 years on Panel and so are already up to speed with the regulatory perspective before new ideas are brought to them;
- individual and high level advice to the regulator on specific subjects through regular bilaterals and ad hoc sub groups with Panel chairmen and members outside the formal meeting process;
- Cross sectoral membership provides a focus on effective regulation rather than the sectoral interests of trade associations, which have a separate place in discussions with the regulator;

Transparency and public accountability

- fulfilment of the Government's requirements for transparency and public accountability in the regulators – 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;
- A possible continuation of the Practitioner Panel's biennial survey of regulated firms which has proved a useful tool for the FSA and provides feedback on how the regulator is performing against its objectives in delivering regulation;

Feedback on coordination between regulators

- commentary and appropriate advice on the coordination of regulatory requirements could be achieved if PRA Panel links to FCA Panels.

The Panel recommends that:

- The PRA has its own Practitioner Panel for consultation and engagement purposes;

and

- A Practitioner Advisory Panel (with representatives of all Practitioner and Market Panels) is set up to look at overall coordination of regulation between the PRA and FCA.

11. What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the FCA?

We welcome the proposed name change to the Financial Conduct Authority and its focus on protecting and enhancing the UK financial system. We are pleased to see a more appropriate balance between consumer protection and consumer responsibility in this consultation.

We are concerned about whether the single objective will allow the FCA to uphold the different approaches necessary for regulation in the retail and wholesale market. This is a vital difference, and it must be maintained in the new system.

We would also like to register ongoing concern about whether the regulation of markets will have clarity of purpose within the FCA's current objectives. We welcome the emphasis on a 'proportionate and tailored' approach. However, the regulation of markets requires a broad approach which encompasses stability and systemic risk issues as well as conduct, and it is difficult to see a clear remit for markets regulation within the FCA's objectives.

We support the proposed operational objectives of the FCA, and that the FCA should discharge its general functions in a way which promotes competition.

We are concerned that in the objectives, there is little explicit recognition of the FCA's role in prudential regulation of a large proportion of firms – the consultation paper numbers it at around 18,500 firms. The FCA will need to pursue some proactive and intensive prudential supervision for some of these firms. The Government and the regulators must be careful not to allow there to be a simple categorisation of the FCA as a conduct regulator. There could be a danger of undermining the FCA's work in this area, and its ability to attract quality staff to undertake prudential supervision.

We support the proposed regulatory principles, and the proposal that both the PRA and FCA should have the same regulatory principles. We believe that this will help firms to expect similar treatment from both regulators. In addition, we have already suggested in answer to Q5 that there should be an explicit commitment in the regulatory principles to coordination with the other regulator where relevant.

12. What are your views on the Government's proposed arrangements for governance and accountability of the FCA?

We welcome the proposal for the governance and accountability of the FCA to be based on that which has worked well for the FSA.

We can see benefits to establishing a new Markets Panel for the FCA. This may well go some way to ensuring that the FCA has a clear focus on its responsibilities in regulating the markets and wholesale activities. However, that focus must be developed within the FCA itself, and then can be debated with this Panel. There are few details of the role and

remit of the Markets Panel included in the consultation, but we understand that it will have a broad focus on wholesale and markets issues and we support this.

We are also pleased that the proposal to make the Smaller Businesses Practitioner Panel being made into a statutory panel has been broadly supported.

We believe that there will need to be a system to bring together the interests of practitioners across the Panels in debates with the FCA. We also believe that there should be a means for the Panels to engage in debate with the PRA as well as the FCA: dual regulated firms will have fully integrated business plans, and the regulation of conduct cannot be entirely separated from the regulation of the prudential side of a business. Therefore, we suggest that there should be a Practitioner Advisory Panel, or Practitioner Coordination Panel. It should have representatives of all the FCA Panels – together with the PRA Practitioner Panel if one is set up. It should be able to look across the regulatory system and provide the perspective of firms on how coordination is working, and where there are problems. This Panel could also have a role in commenting as part of the annual review of the MOU on coordination between the PRA and FCA.

The requirement on the FCA to produce a report on regulatory failure could provide useful lessons in the future. It may be useful to consider if the Treasury Select Committee could have a specific power to write to the Treasury to trigger a report, in addition to the power of the Treasury itself.

13. What are your views on the proposed new FCA product intervention power?

We appreciate that the logical conclusion of the regulator having a more proactive role in the prevention of consumer detriment is that the FCA will have a product banning power. However, the powers of product intervention for the FCA need to be clearly delineated, as it could become a double edged sword for the regulator and cause more problems than it solves.

We look forward to discussing the FCA's proposals on the principles of the circumstances under which it will use the product intervention power. We believe that this power will be quite difficult to use and there are potential problems in the responsibilities and liabilities of the regulator in the use of it. We question the responsibilities of regulator towards costs incurred by firms when it bans a product which is subsequently agreed by the FCA to be safe. In the opposite situation, the regulator could become liable for consumer losses if a product is not banned which is subsequently found to have caused problems.

In addition, it must be remembered that there are many complex products which are perfectly suitable when sold to certain restricted categories of people. The problems occur when the selling of the product extends to a wider range of people.

There is also a potential problem with European arbitrage – we question whether the FCA will be able to stop a firm setting up elsewhere in the EU and selling a product in to the UK which has the same characteristics as those subjected to the FCA product banning power.

14. The Government would welcome specific comments on:

- **the proposed approach to the FCA using transparency and disclosure as a regulatory tool;**

Although there are benefits in some circumstances to using transparency as a regulatory tool, it must be applied with appropriate safeguards. It must not become the default regulatory tool which is applied in all circumstances.

There will be times when disclosure is not the most effective tool: it could cause immense cost and burden on the firms which have to provide the information and result in so much information being produced that it becomes confusing and is not able to be used effectively by consumers. The information provided can also be misleading in some circumstances. For instance, the Practitioner Panel did not support the FSA's recent moves to publish total complaints data from firms, and did not think the cost benefit analysis supported the FSA's decision. The Panel felt that the information can be misleading: many of the complaints will be from consumers who may want the firm to undertake more than they are able to do under the regulatory requirements – for instance offer a better savings rate, or provide a lower rate loan or larger mortgage.

- **the proposed new power in relation to financial promotions;**

We recognise that this would be a useful and effective power for the regulator. We would ask that the power is accompanied by a direction for the regulator to publish more explanation of why they have asked firms to withdraw a financial promotion. Such information would assist other firms by establishing some financial promotions 'case law' which others could refer to and check their promotions against. This would enable firms to improve their promotions in keeping with the requirements of the FCA, prior to publication, and so protect consumers from the outset.

- **the proposed new power in relation to warning notices.**

We are concerned about any early publication of the details of enforcement action against firms unless there is a clear public interest in the disclosure. Enforcement action against firms is often complex and detailed and any publication of details must have appropriate safeguards. A recent example that illustrates the importance of this is with the recent case of an FSA investigation into the activities of Gartmore fund manager Guillame Rambourg. The revelation of an FSA enforcement investigation had a huge impact, resulting in an outflow of assets and reduction in the share price of Gartmore, such that it was able to be acquired by the rival asset manager Henderson at the end of 2010. In March 2011, and a year after the investigation was made public, the FSA quietly dropped the case.

16. The Government would welcome specific comments on:

- **the proposals for RIEs and Part XVIII of FSMA; and**
- **the proposals in relation to listing and primary market regulation.**

We welcome the Government's decision to keep the UK Listing Authority with the regulation of markets in the FCA.

We support the Government's intention to retain the Part XVIII regime pending the European Commission's review of MIFID. However, we are unconvinced that the technical changes as set out in paragraph 4.116 are required. During the recent financial crisis, there were no failings of the regime governed by Part XVIII, and no failure of

market infrastructure occurred. In fact, infrastructure providers continued to operate their markets effectively and in an orderly manner, remaining open whilst other parts of the financial sector froze up or failed altogether. As such, infrastructure providers were a key stabilising force.

Therefore, we believe that the technical changes should be set out in detail, so that they can be subject to full consultation. We believe the changes may incur additional costs for the industry, without any justification for the changes having been given.

PROCESSES AND COORDINATION

17. What are your views on the mechanisms and processes proposed to support effective coordination between the PRA and FCA?

Many of the proposed mechanisms and processes - such as cross membership of boards and MOUs – are essential to have in place. However, there could still be room for operational inflexibility, as statutory duties can often be difficult and cumbersome to apply. Nevertheless, it will be important to put the high level coordination processes in place, with specific statutory recognition of its importance, so that the processes which will fall in beneath can be cross referenced back to the duty to coordinate.

In order to tackle the duty to coordinate at a day to day level, we would like the general duty to coordinate to be also included in the regulatory principles, as we have noted in our answers to Q5 and Q11. This would give concrete effect to the aspiration that firms should not receive conflicting views (p82 4th bullet). A general duty to coordinate and not give firms conflicting views should therefore be added to the regulatory principles, as set out in Box 3.B.

In our previous answer to Question 10, we suggested that, as well as there being a PRA Practitioner Panel, there should be a Practitioner Advisory Panel which is able to look across the regulatory system. It would be made up of the Chairs of the practitioner panels at the FCA and PRA, and another nominated member from each Panel. It would review the coordination processes, and suggested ways in which the regulatory system could be made more effective. A particular role for the Practitioner Advisory Panel would be for it to take a specific role in the annual review of the MOU on coordination between the PRA and FCA.

18. What are your views on the Government's proposal that the PRA should be able to veto an FCA taking actions that would be likely to lead to the disorderly failure of a firm or wider financial instability?

As there may be times when time critical decisions will be taken, it seems sensible to have the PRA as the lead regulator in this instance.

19. What are your views on the proposed models for the authorisation process – which do you prefer, and why?

We believe that the proposed new stage in the authorisation process to divide 'conduct' and 'prudential' approval is a sensible response to the new regulatory system.

Of the alternatives proposed in the consultation, we prefer the model which means that firms have only to approach one regulator, and therefore undertake one process in order to gain approval. This should make the process more straightforward for firms, although the decision notice must, as is proposed, set out the reasons why either or both regulators have refused permission. There must also then be a route provided for further discussions – the lead regulator cannot hide behind the fact that they were not the regulator who made the decision without providing any forum for debate on how the firm might be able to change in order to gain authorisation.

20. What are your views on the proposals on variation and removal of permissions?

As in our answer to Q19, we would like to see straightforward and simple processes to enable firms to interact effectively with the regulators. We understand that it is sensible for both the PRA and FCA to have the current FSA powers on variation and removal of permissions, and logical that the PRA has a veto for dual regulated firms. However, we would urge there to be a single gateway for firms to apply to when requesting any variations to permissions.

21. What are your views on the Government's proposals for the approved persons regime under the new regulatory architecture?

We believe that the proposals seem sensible in allocating powers between the regulators. Again, as in our answers to Q19 and Q20, we would like to see communication and coordination between the regulators on making these decisions. It seems that the best way of achieving this would be to have a single gateway for firms to access either the FCA, or both the FCA and PRA.

23. What are your views on the Government's proposals on the treatment of mutual organisations in the new regulatory architecture?

We fully support the proposal to require the PRA and FCA to conduct an impact assessment in addition to cost benefit analysis when proposing changes to the rules which affect mutually-owned institutions.

However, we question why such an impact assessment should not be carried out for other firms who will be affected by proposed changes in rules.

24. What are your views on the process and powers proposed for making and waiving rules?

The proposal for the PRA and FCA to each make rules for their areas, with FPC arbitration on financial stability seems sensible. We would only suggest that the FPC would need to make public the result of their arbitration and why they have chosen to take the decisions that they did.

25. The Government would welcome specific comments on:

- **proposals to support effective group supervision by the new authorities – including the new power of direction; and**
- **proposals to introduce a new power of direction over unregulated parent entities in certain circumstances?**

We support the principles behind these proposals as being appropriate.

We have one comment to make on the proposals to introduce a new power of direction over unregulated parent entities in certain circumstances. There is a concern amongst some firms that other countries are watching the UK's decision in this area. Overseas governments may then look to introduce a similar power in their countries to enable their regulators to extend their powers over firms owned in the UK. The UK Government should be alive to the implications of such quid pro quo actions by other countries.

28. What are your views on the Government's proposals for the new authorities' powers in respect of fees and levies?

It will be important for the proportionality principle to be maintained in this area. We would like to ensure that there is dialogue with practitioner representatives at a meaningful point in the process to ensure there is consideration of cost effectiveness and efficiency in the setting of budgets and fees.

This is another area where our proposed Practitioner Advisory Committee, as set out in our answer to Q10 could have a role in advising on the cost effectiveness and coordination in the budgets of each regulator, and highlighting any areas of duplication.

COMPENSATION, DISPUTE RESOLUTION AND FINANCIAL EDUCATION

29. What are your views on the proposed operating model, coordination arrangements and governance for the FSCS?

We believe that the proposals for the operating model and coordination arrangements for the FSCS seem reasonable.

We would like however, to make the point 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. In January 2011, investment management firms were unexpectedly required to contribute £236m towards the cost of the FSCS compensating investors who lost money in the collapse of Keydata. This was because the claims went over the limit of contributions allowed from the intermediary sector. The contributions from individual medium and larger investment management firms went into millions of pounds – making a significant impact on those firms' bottom line. The FSA has claimed that it has no responsibility to consider the impact of FSCS levies on the finances of firms.

We believe that the current regulatory changes provide an opportunity for this situation to be changed. The Government should introduce a requirement on the regulator to consider the impact on those sectors affected by any contribution requests for the FSCS which go near to the limits in future.

We would also like to point out that the Keydata-FSCS issue is a good example of how a conduct issue in a single fairly small firm can create potentially significant prudential issues across a wider range of firms crossing the FCA/PRA divide. This illustrates how important coordination between the regulators will be in the new system.

30. What are your views on the proposals relating to the FOS, particularly in relation to transparency?

We support these proposals as being reasonable.

31. What are your views on the proposed arrangements for strengthened accountability for the FSCS, FOS and CFEB?

We support the proposals for the accountability of the FSCS and FOS.

We are particularly concerned about the management of costs in relation to CFEB. This is because CFEB has very broad objectives, which make it very difficult to set a tight budget. Given the potentially enormous costs, particularly now that Government half funding has been withdrawn, we believe that CFEB should have a requirement to publish a budget and consult on it with industry.

EUROPEAN AND INTERNATIONAL ISSUES

32. What are your views on the proposed arrangements for international coordination outlined above?

We welcome and support the greater recognition of the importance of coordination with EU and international in this consultation, compared to the last consultation paper.

However, we remain concerned that these changes are taking place during a period of general regulatory change and uncertainty: a new system for financial regulation in Europe is being introduced and international initiatives such as Basel 3 and Solvency II are just being implemented, while other agreements are still being negotiated. Many aspects of the new regulatory system will need to be adapted to fit international agreements as they are developed.

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 separate evidence to this Inquiry.

4. The names of the members of the Practitioner Panel as at 14th April 2011 are as follows.

Panel Member	*Position*
Iain Cornish *Chairman*	Chief Executive, Yorkshire Building Society
Russell Collins	Head of Deloitte UK Financial Services Practice
Colin Grassie	Chief Executive Officer UK, Deutsche Bank
Mark Hodges	Chief Executive, Aviva UK
Simon Hogan	Managing director, Institutional Equity Division, Morgan Stanley
Garry Jones	Group Executive Vice President & Head of Global Derivatives for NYSE Euronext
Guy Matthews	Chief Executive, Sarasin & Partners [Chairman SBPP]
Helena Morrissey	Chief Executive Officer, Newton Investment Management
Andrew Ross	Chief Executive, Cazenove Capital Management Limited
Malcolm Streatfield	Chief Executive, Lighthouse Group plc
Paul Swann	President & Chief Operating Officer, ICE Clear Europe Ltd
Douglas Webb	Chief Financial Officer, London Stock Exchange Group
Helen Weir	Group Executive Director Retail, Lloyds Banking Group plc

APPENDIX 2

A paper on the Prudential Regulatory Authority's arrangements to consult with the financial services industry as proposed in HM Treasury consultation, February 2011

EXECUTIVE SUMMARY

The Government and the Bank of England have made it clear that the regulators should only be accountable to Parliament, and not to the industry it regulates. We agree that we do not see the regulators as answerable to the industry in what they seek to achieve. However, engagement with the industry at an early stage of policy development has significant benefits for regulators as well as firms. We believe that this should be incorporated into the set up of the PRA as well as the FCA.

Benefits of Structured Engagement
We believe there are significant benefits to establishing a mechanism for structured and ongoing liaison between the PRA and firms. We believe a statutory Panel or similar structure would provide:

Structured forum for engagement

- a forum for debate to help the regulator to understand what is required to successfully implement policy proposals whilst avoiding any unreasonably detrimental impact on firms; consideration of costs versus benefits in accordance with regulatory principles; any potential for misinterpretation of judgement-based regulation requirements on both sides; how prudential interacts with conduct requirements from the firms' perspective; and the impact on businesses and consumers more widely.
- early, pre-publication engagement with industry, as Panel members can be signed up to confidentiality requirements, allowing early debate on the pros and cons of new policy developments
- A forum for practitioners to 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 – the regulators do not have to follow the advice, but should consider it (the current section 11 power)

Contribution to EU and international negotiations

- Contribution to effective EU and international representation for PRA, with a means of facilitating proactive and early involvement of the industry in EU developments
- Advice on ensuring that EU rules deliver the desired objectives in as efficient and effective way as possible eg 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

Well informed and quality membership

- High level membership – usually CEO level. 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. Members serve 3-6 years on Panel and so are already up to speed with the regulatory perspective before new ideas are brought to them;
- individual and high level advice to the regulator on specific subjects through regular bilaterals and ad hoc sub groups with Panel chairmen and members outside the formal meeting process.
- Cross sectoral membership provides a focus on effective regulation rather than the sectoral interests of trade associations, which have a separate place in discussions with the regulator

Transparency and public accountability
- fulfilment of the Government's requirements for transparency and public accountability in the regulators – 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.
- A possible continuation of the Practitioner Panel's biennial survey of regulated firms which has proved a useful tool for the FSA and provides feedback on how the regulator is performing against its objectives in delivering regulation

Feedback on coordination between regulators
- commentary and appropriate advice on the coordination of regulatory requirements could be achieved if PRA Panel links to FCA Panels

The Panel recommends that:
- The PRA has its own Practitioner Panel for consultation and engagement purposes; and
- A Practitioner Advisory Panel (with representatives of all Practitioner and Market Panels) is set up to look at overall coordination of regulation between the PRA and FCA.

PRA ENGAGEMENT WITH PRACTITIONERS – DETAILED COMMENTS

1. Introduction

1.1 In February 2011 HM Treasury published a paper: "A new approach to financial regulation, building a stronger system" as a follow up to the original July 2010 financial reform proposal. Responses are due by 14 April 2011.

1.2 This proposed reform deals with setting up the "twin peaks" approach to financial regulation and the Bank of England's role. In this paper we consider only one specific matter, which relates to the way in which the Prudential Regulatory Authority ("PRA") will consult with the financial services industry and, in particular whether there is a potential role for a standing body similar to the Financial Services Practitioner Panel in respect of the PRA.

1.3 The February paper envisages retaining the existing statutory Practitioner Panel and related Consumer Panel arrangements for the proposed Financial Conduct Authority ("FCA") which will also be required to establish a Small Business Practitioner Panel on a

statutory basis, and a new panel for Markets Practitioners[3]. In respect of the PRA there is no equivalent proposal in the HMT paper to retain or set up panel-like bodies; instead, the PRA is required to engage with the regulated industry and wider public through various mechanisms, one of which is " *a duty to make and maintain arrangements for consulting industry practitioners"* [4]. This is the question we consider in this response: should a body similar to the Financial Services Practitioner Panel, or a different standing body, help to fulfil the requirement for the PRA to consult with the financial services industry, and potentially engage with more widely, or should the arrangements rely solely on ad hoc industry consultation on specific matters?

1.4 In his recent comments to the Treasury Select Committee ("TSC") the Governor of the Bank of England, stated (as recorded in the preliminary, uncorrected transcript): "At present, before any individual regulatory Act can be made or changed, there has to be a detailed cost-benefit study and often consultation with the industry. Now that makes no sense for a regulator to have to go through all those steps. We should be accountable to you, and if people think the way are conducting regulation is inappropriate, then we should be held accountable by you for not regulating the industry in an appropriate way. But we shouldn't be accountable to the industry itself. That is one of the things that has gone wrong in the past. Our job is to make prudential judgements about the risks on the balance sheet".

1.5. Whilst the post 2007 events in financial markets need to be fully considered in the HMT proposals, the merits or otherwise of industry consultation were also debated extensively in the previous round of reforms. The Financial Services and Markets Act 2000 ("FSMA") required the Financial Services Authority ("FSA") to set up and maintain two bodies: the Practitioner Panel (originally known as the Practitioner Forum)and the Consumer Panel [5]. This was one of the proposals to respond to concerns that the new

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[3] Section 4 of the document covers the FCA and states:" 4.*38 Respondents also welcomed the Government's proposal that the FCA should retain the Practitioner and Consumer Panels, and put the Smaller Businesses Practitioner Panel on a statutory footing. They also suggested a separate markets panel be established. The Government will therefore legislate for Practitioner, Smaller Business Practitioner, Markets and Consumer Panels for the FCA. "*

[4] *Section 3 (PRA) Engagement with practitioners and consumers (points 3.68 to 3.73) states: "3.69 The role of the existing Practitioner Panel is to consider how far the FSA is meeting its statutory objective and balancing its 'have regards' from an industry standpoint, and how far it is giving due regard to the considerations set out in the legislation. It is independent and free to publish its views on the FSA's work. It will be essential for the PRA to engage practitioners if it is to regulate effectively, and to engage with trade bodies and industry representatives where they have appropriate expertise. However, in line with the new 'judgement-based' approach, the Government intends to give the PRA flexibility in deciding what kind of arrangements it wants to establish, but to require that whatever arrangement is put in place is transparent and public. 3.70 The PRA will therefore be under a duty to make and maintain arrangements for consulting practitioners on the extent to which its policies and practices are consistent with its role as prudential regulator, and to make the arrangements public."*

[5] Extracts from the Practitioner Panel web site: "The goal was to create a high-level body, which would represent the views and interests of regulated firms in the regulatory decision-making process, and monitor the regulator's effectiveness. The Financial Services and Markets Act 2000 granted the consolidated financial markets regulator, the Financial Services Authority (FSA), considerable powers. As part of its accountability framework, the FSA was required to set up and maintain two statutory bodies – the Practitioner Panel and the Consumer Panel - to monitor the regulator's activities, ensuring that both buyers and sellers of financial products have a voice in the regulatory process. In 1999 the FSA also set up the Smaller Businesses Practitioner Panel to represent the views and interests of smaller regulated firms. Its Chairman is also an ex officio member of the Practitioner Panel. The Practitioner Panel received statutory status under Section 9 of the Financial Services and Markets Act 2000. On 18 June 2001, the commencement order giving statutory status to both the Practitioner and Consumer Panels under the Act came into force. Section 11 of

integrated regulator, the FSA, had considerable powers in respect of firms and individuals and potentially could use those powers in a manner which was unreasonably detrimental to the industry from a commercial viewpoint, to individual practitioners from an enforcement viewpoint or to the interests of the UK as a whole. It was the perception of a concentration of powers in the FSA which led to the call for statutory panels.

1.6 The Practitioner Panel's key remit under the FSMA and associated regulations has been to represent the interests of practitioners, and to provide input to the FSA from the industry in order to help it in meeting its statutory objectives and its principles of good regulation. Together with the Consumer Panel and the non statutory Smaller Businesses Practitioner Panel, it has therefore played a role in the consultation and regulatory framework of UK financial services regulation. The Practitioner Panel has seen its main role as being that of a 'constructive critic' of the FSA. It has aimed to speak across all sectors of financial services in offering input at a strategic level on important policy issues. The Practitioner Panel has had no directly employed staff, but has been supported by staff on the FSA's Independent Panels Secretariat. Members of the Panel do not charge for their time spent preparing for, and attending, monthly meetings of the Panel and various other ad hoc meetings. The Panel has requested on a few occasions a small budget from the FSA for specific research; ad hoc related expenditure, such as the cost of the Panel's Annual Report and of the Survey of Regulated Firms, is agreed with, and paid for, by the FSA.

1.7 The Practitioner Panel Chairman has met regularly with the Chairman of the Consumer Panel and with the Chairman and Chief Executive of the FSA, through whom he had access to the FSA Board, to discuss issues of particular importance and to raise any emerging concerns. The Practitioner Panel has also submitted a monthly Transmittal Note to the FSA Board, to highlight points raised in the course of its monthly meetings. The Practitioner Panel's Annual Report has been the subject of a formal presentation to the FSA Board. There have been frequent contacts between Practitioner Panel members and Directors and Senior Executives of the FSA. FSA Managing Directors attend Practitioner Panel meetings two or three times a year to provide an update on current issues within their responsibility; and senior FSA executives regularly attend meetings to present on policy developments, seeking the Practitioner Panel's views before going out to wider formal consultation. In addition, from time to time FSA non executive Board members have met with Panel members and also attended full Panel sessions. The Practitioner Panel has estimated that in the past 3 or 4 years it has spent the majority of its time on regulatory matters that span both conduct and prudential areas, with Panel discussions approximately equally split three ways between specific conduct issues (such as treating customers fairly and retail distribution), prudential issues (such as capital, liquidity, recovery and resolution plans),and matters relating to the FSA's overall budget and regulation.

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the Act brought an important part of the formal accountability of the FSA to the Panels into effect. This requires the FSA to consider representations made by the Panel and, where it disagrees with a view expressed or proposal made in a representation, to provide the Practitioner Panel with an explanation in writing of its reasons for disagreeing. The same also applies to the FSA's relationship with the Consumer Panel.

1.8 The Practitioner Panel has taken care to ensure it does not duplicate the important work of the trade associations in representing the views of their members. The associations have the staff and resources to promote the interests of their respective members in response to the impact of FSA policies on the sector they represent. At the same time, the Practitioner Panel has retained close links with the trade associations through regular meetings of Panel representatives with trade body officials, as well as biannual briefings by the Panel Chairman of senior trade association executives, held jointly with the Chairman of the Smaller Businesses Practitioner Panel. In addition, individual Practitioner Panel members often have communications and other links with the trade association representing one sector.

1.8 The Practitioner Panel has conducted and published six biennial surveys of regulated firms, the latest in February 2011 when 4,256 firms (43%) of the total surveyed responded. The main focus of this survey is to find out how the industry feels the FSA is performing its role. However, the survey also asks firms to comment on the role of the Practitioner Panel itself. The survey found that before taking part in the survey 45% of regulated firms had heard of the Panel, although 73% of relationship managed (larger) firms knew about the Panel. Of those able to give an opinion, 86% felt that the Panel and the Smaller Business Panel had an important role to play; 84% agreed that the Panels were independent of the FSA and 87% agreed that they helped the FSA to understand industry views; 60% of firms agreed that the Panels were able to influence FSA policies and decisions.

1.9 It is difficult even with hindsight to assess objectively the extent to which the Practitioner Panel's work has made a real difference to the FSA's regulation since it is impossible to make any valid comparison with a hypothetical situation without the existence of Panel and also because the nature of the Panel's dialogue with the FSA has been to engage early and constructively to ensure industry expertise is brought to bear in developing initiatives. However, it is perhaps worth noting some of the specific areas in which the Panel has sought to engage with the regulators in recent years:

- *Effective supervision of firms*: in its early years the Panel communicated to the FSA the importance of focussing on material matters rather than numerous less significant items. Later, the Panel welcomed the FSA's report on its internal review of Northern Rock as a thorough and critical appraisal of its supervisory failings in that case. The Panel has been generally supportive of the FSA's Supervisory Enhancement Programme since 2008 accepting that this increased the cost of regulation, but the Panel's greater concern was to make sure that the programme really delivered more efficient and effective regulation. The Panel pressed the FSA to ensure that it measured the quality of supervision to ensure that the desired regulatory outcomes were achieved. In the past, the Panel has been concerned that the emphasis of regulatory activity has been wrong – notably, the balance between prudential and conduct of business work. The Panel (and the Panel's Survey) have consistently identified the need for greater continuity in supervision staff at firm level.
- *Retail distribution review*: the Panel was supportive of the general aims of the RDR and its ambitions to raise standards in the investment advice sector. However, the Panel believed the impact of the RDR would leave the mass market with more limited access to financial advice, together with the likely increase of costs in producing products and registered considerable concerns about the

transitional arrangements and delivery of the training required by 2012.The Panel believed this would result in a significant reduction in the availability of advice.

- *Treating customers fairly* (TCF): the Panel was supportive of the TCF target outcomes. However, the Panel felt strongly that the TCF programme had become excessively preoccupied with granular detail turning TCF into a series of process oriented tasks rather than focusing on outcomes, which was at odds with the spirit of regulation. The Panel called for a fundamental overhaul and review of TCF and welcomed the FSA's decision in 2008 to conduct some detailed work on assessing the costs, burdens and impact of TCF.
- *International regulation*: the Panel has consistently encouraged the FSA to take a leading role in the development of European and international regulation. Financial services firms and the UK economy as a whole benefit from UK representatives taking an active and positive part in international policy developments, particularly in the wake of the recent global financial crisis. The Panel was concerned at the level of influence which could be exerted both by the FSA and also by the UK as a whole in this vital area but was pleased that the FSA increased its focus and resources in European and international policy development in 2009/10. The Panel expressed its support for the stance taken by the FSA on a number of European regulatory developments, particularly Solvency 2 and hedge fund regulation.
- *Decisions to pursue individual regulatory initiatives and cost benefit analyses* (CBA): the Panel has routinely reviewed with FSA plans for regulatory initiatives across conduct and prudential areas. The Panel has intervened on several occasions to request sight of CBAs and in some cases has suggested changes. For example, the Panel welcomed the decision to reduce the retention period on taping from 3 years to 6 months. The Panel felt strongly that the FSA should have arrived at its decision on the retention period much earlier on in the process, the root cause being a contentious CBA which had significantly underestimated industry costs. More recently, the Panel has raised in discussions questions over the EU Solvency II requirements for insurers. The Panel remained concerned about the prominence, quality, transparency and robustness of CBA within the policy making process and beyond.

2. Potential role for a body such as the Practitioner Panel in respect of the PRA

2.1 In considering how the PRA should consult with the industry in response to the HMT consultation and whether this would be best achieved by arrangements which include a panel-like role, there are different considerations in respect of a)accountability to; and b) consultation and engagement with regulators to industry. Each is considered below but since the responses to both depend on the objectives and governance arrangements of the PRA, it is first necessary to understand the proposed PRA.

The PRA -Background

2.2 According to the consultation paper, the PRA will be an operationally independent subsidiary of the Bank of England and will have a strategic objective focusing on financial stability, with an operational objective that highlights the role of the PRA in promoting the soundness of firms in a way that does not rule out the possibility of firm failure[6]. This

[6] *In discharging its functions the PRA must, so far as is reasonably possible, act in a way which a. is compatible with its strategic objective and b. advances its operational objective. The PRA's strategic objective is: contributing to the*

objective is similar to that of the Bank of England's Financial Policy Committee ("FPC"). The PRA will be accountable to the Court of Directors ("Court") of the Bank of England for administrative matters, including its budget and remuneration policy, value for money and performance against objectives. Court will also review the PRA's strategy.

2.3 There will continue to be regulatory principles for the operation of the PRA (and the FCA [7]. In addition, the paper stresses that: "the openness and disclosure principle, relating to the availability of relevant information, highlights the importance of openness and disclosure as a regulatory tool. This recognises the importance of the availability of clear and objective information in ensuring ongoing market discipline. This principle is balanced against the fact that it will not always be appropriate for information to be disclosed, for example where disclosure would harm the regulator's achievement of its objectives. Finally, the transparency principle underscores the importance of ensuring that the regulated community and general public are able to understand about regulatory processes and how they operate, for example, procedures dealing with complaints."

2.4 The paper also states that: "The PRA will take a judgement-led supervisory approach to the firms it regulates. While this approach will focus on forward-looking analysis, it will also include an assessment of how the firm would be resolved if it were to fail and the impact this would have on both the financial system as a whole (including other PRA firms) and the possible use of public funds. The PRA will draw on this analysis as part of its proactive approach to identifying weaknesses within firms, supported by intervention to require firms to address these weaknesses, where appropriate. "

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promotion of the stability of the UK financial system. The PRA's operational objective is: promoting the safety and soundness of PRA authorised persons. Promoting the safety and soundness of PRA authorised persons includes seeking, in relation to each PRA authorised person, to minimise any adverse effect that the failure of that person could be expected to have on the UK financial system.

[7] *The regulatory principles applied to the PRA and FCA are:*

i) *the need to use the resources of each regulator in the most efficient and economic way;*

ii)*the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction;*

iii) *the general principle that consumers should take responsibility for their decisions;*

iv)*the responsibilities of the senior management of an authorised person in relation to compliance with requirements imposed by or under this Act;*

v) *the desirability in appropriate cases of each regulator making information relating to authorised persons or recognised investment exchanges available to the public, or requiring authorised persons to publish information, as a means of contributing to the advancement by each regulator of its strategic and operational objectives; and*

vi) *the principle that the regulators should exercise their functions as transparently as possible.*

2.5 With respect to the PRA Board, “the role of the non-executive directors will be to constructively challenge the executive and help develop proposals on strategy and policy. To ensure that the PRA board can perform a robust challenge function, the Government will legislate to provide that the board will have a non-executive majority. The legislation will also provide that non-executive directors must be independent and free from material conflicts of interest. “

Accountability

2.6 The HMT paper states that: “Transparency and accountability are key elements of the Government's efficiency and reform agenda.... the most immediate line of accountability for the PRA will be to the Court of the Bank of England, which will hold the PRA accountable for budget and remuneration policy, value for money and other matters. ... Parliament, and specifically the TSC, will take the primary role in holding the PRA to account”. (In this regard it is worth remembering that in setting up the FSA much emphasis was given at that time to proposed twice yearly appearances at the TSC of the FSA chairman).The Government envisages that in the new system:

- Treasury Ministers will satisfy themselves that the regulatory system as a whole is functioning properly, and will be accountable to Parliament on that basis;
- Parliament will hold the PRA publicly accountable for the achievement of its statutory objective and ‘have regards’; and
- The general public, as the ultimate stakeholder in the regulatory system, has a right to information about the operation of the system and the way that the PRA supervises.

2.7 The accountability of any regulator, such as the PRA, requires a consideration of its particular objectives, its organisational structure and its place in the government structure but also the appropriate democratic and representation arrangements, such as appeals against its decisions, disclosures etc, balanced against its independence to ensure regulatory decisions are taken in an objective manner. Accordingly, the best form of accountability is a complex question to answer. There is a strong argument, however, for ensuring that the firms in the financial services industry should have some input to what the PRA does. Aside from the way in which costs of regulation are funded, which will continue to be via levies on industry which ultimately become a cost to consumers, there is also the question about who picks up the bill when there are regulatory failures, either of individual firms, or of a systematic nature, which have been brought to the fore following the 2007 and 2008 instability. The Financial Services Compensation Scheme arrangements have required firms to provide very significant amounts of money to repay consumers.

2.8 The HM Treasury proposal does not envisage any accountability by the PRA directly to practitioners. The implicit concern must be that the regulators are, in some way, ”captured”, or “unduly influenced” by the industry and that this somehow influences them to such an extent that they do not impose the right regulatory approach. Practitioners argue that under the FSA regime the regulators were not “captured” in this way; regulators were required to consult with industry but made their own decisions under the FSMA. In other words, the FSA was not ultimately accountable to the industry but did have a responsibility to protect consumers and enhance financial stability and market confidence

in a way that was proportionate and cost-effective. Again, at the time of the setting up of the FSA this distinction was recognised. Industry commentators at the time noted that the FSA did not have to follow the advice of industry[8]

2.9 However, ultimately the question of accountability is probably more one of democratic and political representation rather than theoretical or practical implementation of strong cost effective regulation and accordingly the Practitioner Panel accepts that in the new structure of regulation accountability is ultimately to Parliament. The question of accountabilityis, however, important not only to the PRA but also the Bank of England given that the PRA is a subsidiary of the Bank. In this regard it is noteworthy that on 3 March 2011 the TSC announced an enquiry into the Bank of England [9]. This enquiry could also consider the specific issue about the PRA's accountability as one aspect of the Bank's accountability. For the purpose of this response, however, accountability is not considered further and we concentrate on consultation and engagement with industry to inform the future prudential regulators.

Engagement and consultation

2.10 If the PRA is not to be accountable as such to the financial services industry, practitioners believe there should be clear and effective arrangements for consultation and these should also include proper engagement with the industry, not least to inform and equip regulators to make better decisions but also over the cost-effectiveness of the solutions proposed. How should ithe PRA therefore best engage or consult with the industry?

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[8] *Money Marketing 4 October 2001, two months before the FSA obtained its powers wrote (http://www.moneymarketing.co.uk/analysis/n2-the-future/66070.article):The consumer and practitioner panels ..."have the power to make statements and recommendations. The FSA has to pay attention but it does not have to heed their advice, which limits the influence of these two bodies."*

[9] On 3 February 2011 the Treasury Committee reported on the Government's proposals for Financial Regulation. It commended the Bank of England's engagement with Parliament over the MPC. The Government's proposals would extend the responsibilities of the Bank to include monitoring financial stability and taking action against threats to that stability. The prudential regulator, the Prudential Regulation Authority, will be a subsidiary of the Bank of England. The Government's own consultation notes:
"These changes to give the Bank control of macro-prudential regulation and oversight of micro-prudential regulation will mean a much greater and more operational role for the Bank in the financial system. This will have significant implications for the Bank in terms of its staff, resources, governance and transparency."
The Committee is accordingly launching an inquiry into the Bank of England, to give this issue the attention it deserves. Key questions will be:

* What kind of decisions should made by each body within the Bank?
o Discussion focuses on the MPC and FPC but are there other policy functions within the Bank's remit which deserve attention?

* To whom should the Bank be accountable?
o Are different accountability mechanisms needed for different functions?

* Are the responsibilities of the Court of the Bank of England clear and appropriate?

* Are the members of the Court of the Bank and the arrangements for its members' appointment and dismissal appropriate?

* What resources does the Bank of England need to carry out its functions?

2.11 On consultation, HM Treasury's paper states that: **"**The Government proposes that there should be no significant reductions to the existing requirements to consult set out in the Financial Services and Markets Act. The PRA will be under an obligation to publicly consult when it makes rules except where to do so would be prejudicial to its objectives. The Government's view is that new regulators must be rigorous in their analysis of the impact of regulation on industry. As a judgement-based regulator, the PRA must focus on increasing the quality of regulation rather than its quantity. However, it is clearly unrealistic to expect that the regulator will produce quantitative cost-benefit analyses especially where it is not possible to monetise or quantify costs and benefits in a meaningful way. The existing FSMA framework allows a substantial amount of discretion to be exercised; the Government believes it will be appropriate to clarify how proportionality will be applied in analysis by the regulators as part of the CBA process. The Government will also give further consideration to the question of whether the requirement to consult could be streamlined when implementing EU rules."

2.12 On engagement with practitioners and consumers, the paper states: "Many respondents to the July consultation recommended retaining the Practitioner Panel and Consumer Panel, in order to ensure that the PRA maintains contact with industry and the wider public. The role of the existing Practitioner Panel is to consider how far the FSA is meeting its statutory objective and balancing its 'have regards' from an industry standpoint, and how far it is giving due regard to the considerations set out in the legislation. It is independent and free to publish its views on the FSA's work. It will be essential for the PRA to engage practitioners if it is to regulate effectively and to engage with trade bodies and industry representatives where they have appropriate expertise. However, in line with the new 'judgement-based' approach, the Government intends to give the PRA flexibility in deciding what kind of arrangements it wants to establish, but to require that whatever arrangement is put in place is transparent and public. The PRA will therefore be under a duty to make and maintain arrangements for consulting practitioners on the extent to which its policies and practices are consistent with its role as prudential regulator, and to make the arrangements public. A number of respondents to the July consultation suggested that the PRA should be required to maintain a standing consumer panel, for the purposes of seeking views from consumers about the effectiveness of its regulation. While consumer issues will be integral to the new regulatory structure – particularly with the creation of a dedicated new consumer protection regulator – on reflection the Government does not think that it will be necessary to retain the consumer panel for the PRA."

The international dimension

2.13 The FSA has summarised in its Business Plan 2011/12 how the international regulatory agenda is increasingly shaping the domestic regulatory priorities. The FSA chairman stated: "Ensuring that we achieve good international agreements is very resource intensive, requiring us to engage on many levels in the Financial Stability Board (FSB), the Basel Committee, the International Association of Insurance Supervisors (IAIS), and International Organization of Securities Commissions (IOSCO)."

2.14 However, it in the European Union developments that the most impact will be felt. The FSA chairman stated: "Influencing the European agenda is the reality that these authorities will play an increasing role in setting the rules within which firms have to operate and which the future UK authorities will have to enforce."

2. 15 The FSA Chief Executive stated: “It is also important to recognise the implications of the change in the European Union (EU) regulatory landscape. As of 1 January 2011, the EU created the new European Supervisory Authorities (ESAs). These will be the key policymaking forums in the EU, leaving the FSA and its successor bodies primarily acting in a policy influencing and national supervisory role....These new bodies will fundamentally change the way in which we operate, both as a rule-maker and a supervisor of firms. They will have decision-making powers over national supervisory authorities, something which the Level 3 Committees did not have. They also have the power to submit draft rules for the European Commission to endorse, where they are authorised to by a specific provision in a sectoral directive. The FSA has become the supervisory arm of a European rule-making process, so our role in policy development is primarily that of influencer, not arbitrator. The EU and its new supervisory authorities have an ambitious agenda for regulatory reform in the financial sector. It is vital that the UK has a strong voice in these new authorities and we have been successful in ensuring we do. We have secured senior representation in all three ESAs through appointments to the management boards of ESMA and EIOPA, and the vice-chair of the European Banking Authority (EBA).” Practitioners agree with this assessment and believe that prudential regulation is subject to international policy setting even more than conduct regulation.

How could a standing panel of practitioners help achieve the most appropriate consultation and engagement aims?

2.16 Specific regulatory initiatives would, in the view of practitioners, benefit from consultations with industry in the vast majority of business as usual situations (ie outside financial stability crises) to provide input on important aspects of prudential regulation, especially **adherence to the principles such as proportionality. I**t is accepted that in a crisis time pressures and other factors might make it very difficult or even impossible to consult, as indeed was the case recently when the FSA introduced measures around short selling. What would be the advantages of a standing panel compared with relying solely on ad hoc consultations with individual firms or trade bodies or bringing together sub groups of practitioners whenever specific issues were deemed to justify this? One such overriding advantage of a standing body is that it would significantly facilitate **transparency** in the regulator’s dealings with industry, for example via such a body’s own annual report and potentially a survey similar the Practitioner Panel’s survey. But it could also **improve the consultation and engagement process** in a number of ways without impairing the regulator’s ability to fulfill their mandate: these are listed in the following paragraphs.

2.17 The PRA will be required to develop policy initiatives in a variety of prudential areas, some of which are quite complex, which would benefit from practitioner input. Many of these (but not all) will increasingly be derived from international, especially EU, regulatory initiatives. Both in terms of the **UK regulators’ input to the international debates** as these regulations are developed and in terms of their subsequent implementation in the UK, these could benefit from the **expertise of experienced industry practitioners to inform and improve PRA policy development**. Practitioners believe that there has been a tendency in some parts of the UK regulatory structure to “gold plate” EU directives and that this must be resisted unless there is a clear and demonstrable benefit over the costs. But there is also a need to ensure that EU rules themselves deliver the desired objectives in as efficient and effective way as possible and

this requires a deep understanding of how financial markets work and the relevant transmission mechanisms. Examples might be around the precise way in which stress tests are conducted, the different options to increase prudential capital, practical considerations implementing liquidity requirements, the interactions between market infrastructure and payment mechanisms and individual firms.

2.18 A benefit of a standing body of such practitioners compared with ad hoc consultation is that it allows the regulators to engage **early** in the process of developing policies rather than towards the end of their development which can be helpful in avoiding unnecessary costs devising proposals which are subsequently found not to achieve the objectives, or in designing more effective regulatory responses. The discussions can therefore be **forward looking** both in respect of individual policy initiatives and in broader areas such as emerging risks in the industry, pressures on industry resources and the impact of international trends, which are increasingly important. For example, the need for a proactive and early involvement in EU discussions is of great importance and is an area in which the UK authorities have on occasion been criticised.

2.19 In addition, **confidentiality** requirements can be built in so that potentially sensitive matters can be discussed fairly openly with the standing body members. Panel members could serve for, say, three years and so become **knowledgeable about topical regulatory issues**, enabling efficient and effective discussions. If they are from large organisations, they can also tap into their **resources to provide information and responses** to regulators as they consider proposals, subject, of course, to confidentiality requirements.

2.20 A **survey** of industry views, conducted by an independent body such as a panel, could also provide direct input to the PRA's thinking and enhance transparency.

2.21 The **PRA board could also usefully engage** with a standing body such as a panel to ensure that the impact of the PRA's proposed and existing policies on the industry is understood, especially where these deal with complex issues that affect behaviour and international issues.

2.22 A panel would also be **available to the FPC**, if at any time direct industry practitioner input to its deliberations were felt appropriate, for example on the design of macro prudential tools or their effects.

2.23 A Panel comprised of senior industry figures, often people at Chief Executive level, who are committed to inputting to regulatory developments, is able to provide **"joined up**" thinking on regulation, including the knock on effects of regulation on business areas. The **cross sectoral** perspective of industry's priorities and consultation responses provided by a Panel is almost unique and from an industry viewpoint is incremental to the sector based industry associations.

2.24 In a twin peaks model, with conduct and prudential regulation separated, having a panel like body of practitioners for the PRA would provide a useful check to ensure there is **appropriate communication and coordination with the FCA**. One topical example is the way in which the recent Mortgage market review involving arrears and repossessions impacts conduct and prudential matters.

2.25 **Considering the Government's stated commitment to the accountability and transparency of the new regulatory institutions, to have** a Panel which publishes an annual report provides some **consistency and transparency** to any PRA consultation/engagement with practitioners. The annual report could be published (as now) and/or presented to HM Treasury or the Treasury Select Committee. This suggests that such a panel would need to be established on a statutory basis rather than leaving the judgement on whether to establish a panel solely to the regulators.

2.26 A standing group or quasi permanent body therefore has several advantages over ad hoc consultation determined solely by the regulator: it can consider the **cumulative impacts** and effects of both regulation and supervision in a way that fragmented arrangements cannot; it can **build a better understanding of the PRA's objectives and operating practices and act as a better sounding board** as a result; it **demonstrates in a transparent way** how engagement and consultation with industry is taking place; it facilitates senior management engagement since in a practical sense it should be able to **attract CEO level practitioners** who will believe that their views are taken into account by regulators.

2.27 Accordingly, one option is to require the PRA to establish on a statutory basis a Practitioner Panel with a remit similar to the existing panel for the FSA but focused on prudential matters. The remit could, of course, identify specific matters which are within the scope of the Panel. As in the case of the existing Panel for the FSA, such a panel would not adopt the approach of a lobbying organisation, rather it would attempt to **help the prudential regulator understand** and be informed by:

- What is required to successfully implement the proposed policies covering practical matters such as information requirements, systems and information technology, resource and skill issues.
- The options available to the regulators to achieve their objectives (rather than questioning the objectives themselves).
- How the prudential proposals interact with conduct and other regulatory initiatives.
- The impact on businesses and consumers more widely of regulatory proposals, especially insofar as they have to deal with internationally active firms, commenting on adherence to proportionality or other principles.

2.28 In addition to the three statutory practitioner panels for the FCA (Practitioner, Smaller Business practitioner, Markets), and our recommended PRA Practitional Panel, consideration could be given to establishing an "advisory" body of practitioners on a statutory basis which would meet to consider prudential and financial stability matters relevant to both PRA and FCA, and also the proportionality and cost-effectiveness of the measures adopted. This group could include members drawn from the Practitioner and Markets Panels, for example, or the chairs and one other member of each of the four FCA Panels. This body could discuss a predetermined list of matters concerning overall regulation and would also be able to pick up specific prudential matters which could include some retrospective in nature (eg macro prudential initiatives taken, how well FCA and PRA are coordinating from practitioners viewpoint), but also forward looking ones, for example around proposed international regulations, emerging risks, or costs of regulation. If it were non statutory, there would be no guarantee that it would be established to fulfil this mandate and it might be more difficult to attract the right calibre of member.

3. Conclusions- Policy Options Recommended by Practitioner Panel

3.1 The HMT consultation paper allows the PRA almost complete flexibility as a "judgement led" regulator in deciding how to engage with practitioners. Industry input is recognised as an important aspect of the effectiveness of regulation which will be increasingly determined in international fora. We recommend there should be specific requirements set for the PRA to engage and consult with practitioners as a minimum in primary legislation. Put in an histrorical context some of the debates and arguments in favour of industry representation and engagement at the time opf FSMA are still relevant today as the regulatory infrastructure is reshaped.

3.2 Putting aside the question of accountability of the FPC and PRA, practitioners have expressed the view that there should be effective engagement with and consultation by the PRA with industry. Ideally this would be expanded to cover also aspects of the FPC's work. However, for the purposes of this paper the engagement with FPC is not considered further. Engagement with the PRA would provide proactive and early consideration of matters by experienced practitioners to assist the prudential regulator in its discussions with international authorities and implementing regulation in the UK. Such a body could be focussed on input around proportionality, cost effectiveness, influencing the international agenda, coordination with the FCA and ensuring the views of industry are considered when designing and implementing alternative prudential regulations to achieve given objectives There are also benefits around transparency, efficiency and effectiveness of having a standing body with which the PRA could engage and consult. Practitioners believe that there should be a commitment to effective consultation and engagement and therefore that the legislation would benefit from a requirement for a standing body to be established for the PRA. There are several options, including:

(i)PRA has its own Practitioner Panel ie a requirement for the **PRA to set up a statutory Practitioner Panel** similar to those required under current legislation for the FSA and proposed for the FCA. This would be a separate panel from the FCA Practitioner Panel and arrangements would need to be made to ensure there was good coordination between the Practitioner Panels (including the Smaller Business panel) and indeed with the Consumer Panel and markets Panel. **Practitioners support this option**.

(ii) FCA Panels are also given access to the PRA (and vice versa) ie a requirement for the **PRA to utilise the proposed FCA Practitioner Panel** in a manner similar to that required under current legislation for the FSA so that **it would become the Practitioner Panel for FCA and PRA**. This would not require an additional panel for the PRA but would require the terms of reference for the FCA Practitioner Panel to include certain aspects of the PRA's work, including coordination between the regulators. Whether this would be a workable solution depends on how the Panel is constituted. If it were a panel for FCA and PRA then it would probably be **workable and a fairly straightforward solution**. If it were a panel for FCA with only a few minor additions in respect of PRA, from the PRA's viewpoint this would raise a number of **practical difficulties** compared with option (i).

(iii)Practitioner Advisory Panel is set up to look at overall coordination, PRA regulation (possibly also markets in Bank; FPC issues)This would be a requirement for the **PRA and FCA to set up a statutory standing advisory body**, possibly termed a panel or forum, but **with a different role** from the current panels; this could involve a narrower focus

(from a practitioner viewpoint) on how the PRA is coordinating with the FCA to avoid the duplication which can occur in twin peaks, how it is influencing and implementing international regulatory initiatives to ensure that the views of UK industry are being taken into account and to provide a communication vehicle to discuss other regulatory matters. Practitioners argue that this would usefully supplement option (i).

(iv)**No requirement to establish a statutory standing body** for the FSA but a recommendation that the PRA considers establishing a non-statutory advisory body or working with the industry along these lines. This would be a step forward from the consultation paper but essentially **weakens the commitment to effective industry consultation and engagement compared with the existing arrangements and option (i).**.

(v)**No requirement or encouragement for the PRA to set up a statutory standing body**, relying instead on consultation on specific regulatory proposals with firms and other bodies including ad hoc consultation with specific groups of industry practitioners, as required, on particular matters. This is essentially the position in the consultation paper.

3.3 Practitioners would welcome and support consultation and engagement arrangements and wish to provide advice, guidance and input to the PRA. The Panel therefore recommends that:

(i) The PRA has own Practitioner Panel for consultation and engagement purposes; and
(ii) A Practitioner Advisory Panel (with representatives of all Practitioner and Markets Panels) is set up to look at overall coordination of regulation between the PRA and FCA.