THE FINANCIAL SERVICES PRACTITIONER PANEL

RESPONSE TO FSA CONSULTATION PAPER 12/37

'THE FINANCIAL SERVICES BILL: IMPLEMENTING MARKET POWERS, DECISION MAKING PROCEDURES AND PENALTY POLICIES'

1 February 2013

Introduction

The Financial Services Practitioner Panel (the 'Panel') has taken a keen interest in implementing new powers and rules resulting from the Financial Services Act 2012. The Panel welcomes the opportunity to provide written comments on the proposed approach to implementing the Financial Conduct Authority's market powers - applicable to Recognised Investment Exchanges ('RIEs'), sponsors, issuers and primary information providers ('PIPs') - and amendments to the decision-making and penalty procedures.

Our comments focus primarily on the FCA powers in relation to PIPs, powers to direct RIEs and the decision-making powers applicable to all regulated firms.

We have provided our detailed comments below.

Executive Summary:

- We support the proposed regime for PIPs, although note a small number of concerns, including that proposed powers may push the FCA into the role of price regulator in this market;
- We support the regulator having a full regulatory toolkit as applicable to RIEs; however, we hope the new powers will be used sparingly, considering the impact on market confidence and stability, and will not undermine the existing and effective working relationship;
- Amendments to REC 2.17 must clearly reflect the split of responsibilities between RIEs and Recognised Clearing Houses ('RCHs');
- RIEs must be given a reasonable amount of time to make representation over the use of new direction powers;
- We would welcome further clarification of the reasons for removal of guidance at REC 2.9.4 G;
- We fully support the continued use of an independent RDC in the disciplinary decision-making process;
- We express reservation about the publication of warning notices, particularly if they are likely to be requested in every instance. We hope to engage further on this topic when the FSA publishes its warning notices consultation in the coming months;
- The proposed procedural time periods for making representations on warning notices are too short and are inadequate; and
- The FCA should commit to a periodic review of the use of its warning notice powers.

Detailed response:

The Panel supports the FSA fully consulting on the implementation of the FCA's new powers and rules under the Financial Services Act 2012 and we seek to provide comments in relation to certain key proposals in the consultation paper.

1. ***Primary Information Providers***

   Q6: Do you have any comments on our proposals to base the new regime for primary information providers on the existing framework?

Broadly the Panel supports the FSA's proposal to base the new regime for PIPs on the existing framework, which has been effective and operated with very few issues. However, we believe the FSA can improve on the current proposal in a few areas.

The 'continuity of service' provision for PIPs at DTR 8.4.7 poses the unreasonable and unrealistic requirement that these firms must be able to disseminate data between set hours on each business day and receive all regulatory information at all times. Although this is the goal of PIPs, and highly beneficial and necessary for market participants, in practice there may be unavoidable situations where the PIP is not able to provide this service. It is important that PIPs undertake best efforts to ensure they are providing a full service, with appropriate and robust business continuity arrangements. However, unforeseen operational issues or regular scheduled maintenance should not automatically be a breach of the FSA rules. The FSA should give further consideration to how continuous transmission of data can be effected and should seek to work with firms to ensure this occurs in practice.

Under proposed rule DTR 8.5.5(3), the FCA may restrict or limit approval of a PIP where it proposes to make changes to the services offered or fees charged, which would impact on its satisfaction of its obligations as a PIP. The Panel supports the non-discrimination objective (DTR 8.3.1) trying to be achieved by DTR 8.5.5; however, we are concerned that the proposal could lead to the FCA playing a role in setting prices for information services, acting as a price regulator. The regulator should make its policy clear in a statement or rule guidance on how it would seek to use this power (or remove it if there is no need for such power).

In proposed new rule DTR 8.4.3, we understand that the FCA intends that PIPs should disseminate all regulated information as soon as possible, or at least 95% of data that does not require reformatting within 5 minutes. Although this carve out for data requiring reformatting is intended to assist PIPs, we understand that in practice no PIP would require such exception as all data needs reformatting to some extent and current providers have been able to disseminate all data promptly. This proposal would relax standards, potentially providing a worse service to the market.

Q7: Do you have any comments on our proposals for the transitional arrangements for primary information providers?

We support the transitional arrangements for existing Regulated Information Services. However, in relation to incoming EEA information society services (ISS), the current transitional arrangement proposals seem to suggest ISS firms will continue to be allowed to provide a 'PIP service' in the UK, but without being subject to the same requirements as UK PIPs. As we have seen with other types of regulated firm, the ability of non-UK firms to passport into the UK without being subject to the same requirements may lower overall standards and pose risks to orderliness of markets and investor protection. It may additionally encourage UK firms to base themselves outside of the UK in order to benefit from a lighter-touch regulatory regime when passporting in. We would welcome the FSA re-considering the situation with incoming EEA ISS firms to ensure it is comfortable that this arrangement will not contribute to the risks we highlight.

2. Investment Exchanges

We note that the FCA will be handed substantive new powers to fine and censure RIEs and increased powers to direct RIEs. Although it is important that the FCA has all of the tools necessary with which to regulate authorised persons and recognised bodies, and meet its statutory objectives, we would caution against their use in the case of RIEs, except in exceptional circumstances.

Exchanges provide important market infrastructure and have their interests aligned with the regulator in ensuring clean and effective markets, which inspire the confidence of market participants. We are aware that in the past 12 years under which the FSA has operated as the market regulator, there have been no publicised use of the power of direction, nor (to our knowledge) any instances where the FSA has expressed regret about its lack of power to fine or censure RIEs (including during the financial crisis and other market stresses).

The FSA and the RIEs have historically worked together to ensure that UK markets operate effectively and in accordance with both the FSA Handbook and FSMA rules, and the rules in the RIE rulebooks. The relationship has been characterised by open communication, consultation and cooperation, which has been effective to date. The Panel hope that the FCA's new powers will be used sparingly and will not undermine the effective working relationship between the small number of RIEs and the Regulator.

Q8. Do you have any comments on our proposals to amend REC 2.17, to reflect that RIEs will no longer be party to market contracts of the type envisaged by s.155(2)(b) or s.155(2)(c) of the Companies Act 1989?

The Panel supports the requirement for RIEs to maintain and operate default rules with regard to parties who are unable to meet obligations on unsettled contracts. However, the proposed provisions are slightly unclear about the division of responsibility between RIEs and RCHs with regard to defaults on the unsettled contracts. RIEs have rules establishing the contract and default rules applicable to the contract between the trading counterparties (e.g., a

counterparty and a clearing member). However, the RCH will have separate rules applicable to the contract between the clearing member and the RCH, when that contract is subject to clearing. This second instance of default should be settled under the separate default rules of the RCH. Further clarification of this distinction could usefully be made in the guidance at REC 2.17.4G.

Q9. Do you have any comments on the way in which we propose to amend REC to reflect the legislative changes affecting recognised bodies?

As detailed above, while we recognise the benefits of the FCA having a full suite of powers to supervise all regulated parties, the case for using powers of direction or disciplinary powers for RIEs is likely to arise rarely, if at all. We have already stated above that RIEs have interests aligned with the regulator and there has been no previously identified need to use powers such as those that will be newly available to the FCA. Further, it must be recognised that RIEs are systemic in nature and play a central role in the UK market. Any use of direction, censure or imposition of penalties risks impacting market confidence and, possible in extreme cases, market stability. These factors must be given serious consideration before any proposed action is taken by the FCA. We would hope that the FCA shares this view and we would welcome any recognition in the rules, guidance or other policy statement that direction or disciplinary powers for RIEs should only be used in circumstances of strict necessity. In particular, any efforts to encourage cooperation and constructive dialogue instead of use of formal powers should be encouraged.

Where the regulator believes there is a need to use its power of direction against RIEs, we are concerned about the lack of clarity around how long RIEs will have to make representations to the regulator. Currently, RIEs are provided with 2 months to provide their representation, which under the Financial Services Act 2012 changes to be representation within a 'reasonable period of time'. Natural justice can only be achieved if the period of time is truly reasonable, meaning that the RIE has time to consider the grounds for the direction and respond fully, after consultation with senior management and advisers. Although the complexity of the issue may influence what is 'reasonable' in the circumstances, and we recognise the benefits of the flexibility provided by the Act, continuation of clear guidance that 2 months remains a reasonable period of time would be encouraged.

We also note that the FSA has deleted guidance at REC 2.9.4 G providing that RIEs and RCHs may agree to record or report a transaction only once where (for example) they have the same reporting or record-keeping obligation for that transaction. This has previously helped avoid instances of duplicative record-keeping and reporting, which is both burdensome and potentially misleading from a supervisory standpoint. We would welcome further explanation of why this guidance has been removed.

3. Decision Procedures and Penalties

Q15. Do you agree that the RDC should decide whether to exercise these new disciplinary powers?

The Panel fully supports the proposal that an independent RDC would be responsible for exercise of the newly provided disciplinary powers, rather than the FCA executive. This arrangement will ensure the appropriate separation of those bringing enforcement action and those judging the merits of the case when it comes to the imposition of fines and public censure.

Q19. Do you agree with our proposed amendments to DEPP 3?

The Panel has expressed concern over the potential use of the FCA's new power to publish statements regarding warning notices for disciplinary matters. Although we recognise that the FCA may consider that publication of warning notices contributes to its consumer protection objective, the very real risk of unfairness (including undue reputational damage) and, in certain instances, detriment to the stability of the UK markets must be given due weight (particularly where the authorised person or RIE is systemic in nature). We believe that the existence of the power does not necessary mean it is required to be proposed by the FCA enforcement team in every case and that publication will be considered only if there is a reasonable case that the benefits of publication outweigh the costs.

Given the importance of this decision, we support the proposed assignment of the task of making a decision about the use of this power to the independent RDC. The RDC chairman will be required to make difficult decisions about whether a warning notice is justified and will require clear guidance from the FCA executive about their expectations in this regard. We look forward to the publication of a further consultation on the FCA policy around warning notices and their use before LCO and will aim to engage constructively in the policy discussion.

Our key concern with the proposed amendments to DEPP 3 is the guidance at DEPP 3.2.14C G around when the recipient of a warning notice may make representations about the allegations and the shortening of the time period for doing so. Although we recognise the wish for representations on the publication of the warning notice decision not to become a full investigation of the facts of the case, we believe the periods specified are unreasonably short. For example, 7 days is likely to be insufficient time for proper consideration of the matter by compliance staff, consultants and external advisers and senior management, and preparation of a clear and considered written response. In some cases a short time period may be appropriate, but in others much longer may be needed, especially where the facts of the case are complicated, or the party is systemically important or operating in niche markets.

In practice we believe the existing rules around the time to make representations for warning notices at DEPP 3.2.15, which specifies 'not less than 28 days', remains appropriate. If there are likely to be instances where 28 days is too long, we would advocate providing the RDC chairman with flexibility to decide 'what is a reasonable period of time for making

representations given the circumstances'. The proposed period of two days for requesting an extension of the representation period is wholly inadequate and will not provide time to properly consider the facts around the warning notice. It is likely to lead to firms automatically applying for an extension as a matter of course to ensure they have time to consider representation (before even preparing written submissions). A period of at least 14 days, as currently provided for in DEPP 3.2.16 G (1), would be much more appropriate.

Due process and natural justice require sufficient time for consideration of the facts around publication of the warning notice, and the proposed use of the power does not preclude the FCA from using other powers to prevent the sale of certain products, either generally or by the specific provider, if it is likely to cause consumer detriment.

We agree that representations should generally be in writing, addressed to the RDC chairman. However, if the RDC feels representations in person are more appropriate in the circumstances, this should be permitted.

As a safeguard against inappropriate use of the new power, we would encourage the FCA to set out further details of how and in what circumstances it expects to use these powers, and to commit to undertake a periodic review of the benefits and outcomes of the use the power (i.e., lessons learned).

Q20. Do you agree with our proposal to apply the existing penalties and suspensions policies in DEPP to the FCA's new disciplinary powers?

We agree that the exercise of the new disciplinary powers should be subject to the existing penalties and suspension policies in the DEPP sourcebook.

Conclusion

The Panel welcomes the FSA's consideration of how the FCA will use its new markets powers.

Although we support the FCA having enhanced power to censure and direct RIEs where this is necessary, we equally believe that these firms play an important role themselves in ensuring market efficiency and cleanliness. Their systemic nature and central role in the UK market means use of formal power will rarely be appropriate. In practice, our hope is for the continuation of the existing effective working relationship between market regulator and market operator. In relation to PIPs, we support the proposed regime but believe the FSA must give some further consideration to the continuity of service provision at DTR 8.4.7, the power to limit or restrict authorisation on grounds of fees charged, and the regime for incoming EEA ISS firms.

The Panel understands the reasons why parliament has granted the FCA power to publish statements regarding warning notices, and that these may contribute to consumer confidence in the regulator. However, we are concerned by the impact of the use of the power and the

signals it may send to consumers and the market, as well as the possible undue reputational damage to firms. Given these potential issues, it is important that firms have the right to prepare and present reasoned representations on the warning notice statements before they are published. To ensure the power is achieving its desired goals, the FCA should seek to review its use regularly.