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FINANCIAL SERVICES BILL

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Memorandum submitted by Aviva (FS 01)

About Aviva

- We have over 14 million customers in the UK. Globally, 44.5 million customers rely on us for prosperity and peace of mind.
- We have over 17,000 employees across the UK.
- We are the insurance market leader in the UK.
- We have been looking after our customers for over 300 years.
- More customers than ever before are recommending us.
- We are a sustainable business, which meets our financial targets, even when times are tough.
- We are in the top 10% of sustainable companies globally.

Summary

1. Aviva is the UK's insurance market leader with over 14 million customers and over 17,000 employees. We are the only major insurer in the UK that offers both general and life insurance. Our core purpose is to bring prosperity and peace of mind to our customers through good times and bad.

2. We believe that it is the effectiveness of supervision, rather than the structure, that is key to achieving good outcomes for both consumers and firms. There are a number of improvements that can be made to the Financial Services Bill (the "Bill") in the interests of consumers, firms, and the regulators themselves.

3. We ask Parliamentarians to consider the points below when scrutinising and amending the Bill. We consider it important that the Bill require:

(a) the FCA and PRA to identify areas where they can share services and information to minimise unnecessary burdens on firms;

(b) the Treasury to explicitly consider the balance of experience required when it appoints independent members to the FPC and the Boards of the PRA and FCA; and

(c) the FCA to have regard to the potential benefits of consumers accessing suitable financial products that meet their needs.

Accountability

4. It is important that the accountability and governance arrangements of the new regulatory system are strengthened. The new regulatory bodies and the Bank of England should abide by the same corporate governance standards that firms and other private organisations follow.

5. We agree with the Treasury Committee and the Joint Committee that the Court should be replaced by a Supervisory Board with expert members. The Bank's significant new powers in macro- and micro-prudential policy should be paired with reforms to ensure that clear accountability processes are in place.

6. The Court (or Supervisory Board) of the Bank of England, the FPC and the Boards of the PRA and FCA should have a balance of experience from within the financial services industry, including the insurance and asset management sectors. The Joint Committee makes this point in relation to the FPC. The Bill should require the Treasury to explicitly consider the balance of experience required when it appoints independent members to the FPC and the Boards of the PRA and FCA.

7. The PRA's accountability would be strengthened by engagement with a Practitioner Panel and this should be mandated in the Bill. If the panel system of stakeholder engagement is suitable for the FCA then it should be suitable for the PRA.

8. We therefore recommend that clause 2K of Chapter 2 of the new Part 1A of the Financial Services and Markets Act 2000 ("FSMA 2000") be amended so that it mirrors clauses 1M, 1N, 1O, 1P and 1Q of Chapter 1 of the amended Part 1A of FSMA 2000. For clarity, the text of the new Part 1A of FSMA 2000 can be found at Part 2—Amendment of Financial Services and Markets Act 2000 of the Bill (starting at page 15).

9. Consideration should also be given to enabling the Chairs of the Practitioner, Smaller Business Practitioner, Consumer and Markets Panels to formally engage with the FPC.

Double Regulation

10. Uncoordinated "double regulation" with the attendant additional costs and contradictions must be avoided. Duplication will simply lead to unjustifiable extra regulatory costs and an unnecessarily complex regulatory environment. The draft Memorandum of Understanding between the Bank of England and the FCA contains sensible measures, but the Bill should provide more certainty.

11. The Bill should be amended to require the FCA and PRA to identify areas where they can share services and information to minimise unnecessary burdens on firms. Firms should have a single process for standard interactions, like approval of candidates for significant influence functions.

12. We therefore recommend that a new clause is added under clause 3D (1) of Chapter 3 of the new Part 1A of FSMA 2000 to include "that the regulators identify areas where they can share services and information and act to minimise burdens on firms supervised by both regulators."

Europe and International

13. The new EU supervisory architecture, and its interactions with the UK regulatory framework, is very important for businesses like Aviva with operations across Europe. It is critical that the UK regulatory authorities effectively influence EU and international bodies in a timely, consistent fashion and with maximum impact.

14. We welcome the Bill's requirement that the international organisations MOU establish an international regulatory committee and that the PRA and FCA will report on their international engagement.

Due Process

15. A shift to judgement-based supervision should be balanced with a strengthening, not an undermining, of challenge mechanisms for firms. Rules and guidance should be developed using robust cost-benefit analysis and consultation.

16. The proposals in Section 21 of Part 2 of the Bill (Proceedings before Tribunal) to weaken the remit of the Upper Tribunal should be dropped and it should continue to be able to issue directions to the regulators. This will help ensure that the implications of the regulators' judgements can be independently reviewed where appropriate.

17. We agree with the Treasury Committee that the Bill should require far more extensive cost benefit analysis and consultation before making new rules and guidance. The PRA's consultation requirements should be included in the Bill rather than left to the discretion of the PRA. We support the regulatory principle that a burden imposed on a firm by the regulators should be proportionate to the expected benefits.

18. The Bill includes significant new powers for the FCA to ban products and to make public enforcement actions against firms at an early stage. There needs to be proper safeguards around the use of such powers. Also, the FCA needs to be clear about the circumstances in which it would intervene in product development.

Consumers

19. We work hard to produce products that provide prosperity and peace of mind, based on consumer needs. We want to see firms provide suitable products to financially capable consumers in competitive markets.

20. The FCA should be working towards positive consumer outcomes, not just avoiding negative outcomes. Its objectives should require it to work with the industry to promote better consumer access to financial services. We recommend that a new clause is added under clause 1C (2) of Chapter 2 of the new Part 1A of FSMA 2000 to include that the FCA must have regard to "the potential benefits of consumers accessing suitable financial products that meet their needs."

21. Firms are required to follow FSA rules and guidance, high level principles on Treating Customers Fairly and will be subject to a more intensive product intervention regime. It therefore seems unnecessary for firms to also "be expected to provide consumers with a level of care that is appropriate" (part of the FCA consumer protection objective). This principle needs to be scrutinised and clarified.

February 2012

Memorandum submitted by Payplan (FS 02)

Preamble

1. Payplan is a major provider of telephone-based debt advice and solutions. This year we will take on over 100,000 new debt cases. We are a Money Advice Trust partner agency and work closely with other providers within the free sector such as Citizens Advice Bureaux and National Debtline.

We operate using the "Fair Share" model whereby our services are free to consumers and paid for by creditors on a "polluter pays" principle of support in proportion to the amount of their debt we are managing. There is one other major provider funded using the Fair Share model (Consumer Credit Counselling Service) but the majority of operators charge consumers rather than their creditors.

2. There has recently been much discussion on the merits of better regulating the providers of debt management plans (DMPs). This arises from widespread concerns about the cost and quality of services

provided to overindebted consumers including a detailed review by the Office of Fair Trading (OFT) in 2010 which found that:

> "frontline advisers working for debt management companies generally lack sufficient competence and are providing consumers with poor advice based on inadequate information."[1]

Current Legislation

3. Payplan and others believe that existing powers contained within the Tribunals, Courts and Enforcement (TCE) Act 2007, which provide for the introduction of a statutory debt management scheme, could effectively address our concerns. Whilst Government has not ruled out this route:

> "As there are clearly continuing concerns, we do not rule out the possibility of further statutory action in this area, and propose that the current order making powers in the TCE Act 2007 remain in place for the time being."[2]

4. The Government is currently exploring alternative routes:

> "In recognition of the concerns that have been expressed, and in keeping with the Government's commitment to pursue change via non-regulatory routes wherever possible, we will work with the various players within the DMP industry to improve current standards. The Government proposes a series of cross-industry meetings to work up a Protocol setting out what all parties can expect from a DMP. This would work alongside the OFT's recently revised draft guidance, which sets out the standards the OFT expects of debt management businesses, but will be broader in scope as it will encompass the creditor community. Such engagement, however, to consider non-regulatory approaches does not mean we have reached any final conclusion not to regulate in any particular area of debt advice."[3]

5. Payplan sits on a working group established by The Insolvency Service to explore the potential for establishing a debt management protocol. We are confident that it will be possible to produce a protocol which addresses most areas of poor practice identified by the OFT and others. Payplan is less confident though that there will be a straightforward resolution to the issue of fees. The OFT says:

> "Debt management services are a classic "distress" purchase; consumers contacting debt management companies tend to be over-indebted, vulnerable and desperate for help with managing their financial difficulties. Consequently, consumers tend to make quick decisions about debt solutions and research from the Money Advice Trust has shown that consumers do not shop around for debt management services."
>
> "The review also revealed new or emerging unfair business practices in the debt management sector that are not currently covered by the current Guidance such as:
>
> — charging excessive fees disproportionate to the work undertaken. Some businesses were said to charge the equivalent of multiple monthly payments as initial set-up fees. Such practices can be severely detrimental to a consumer who may end up even more over-indebted if creditors continue to apply interest and charges or if the plan fails because they cannot keep up with the payments."[4]

Potential for Voluntary Resolution

6. Payplan considers that a reasonable basis for charging fees should be analogous to the "fair share" model of a percentage of payments distributed to creditors with no initial set-up fee. This aligns the interests of consumers, creditors and providers in setting up plans which are sustainable over the long term and penalising providers who set-up plans which are unsustainable or inappropriate. There is likely though to be a strong commercial incentive for providers to sit outside any protocol. If a significant number of providers join a protocol which limits or removes their set-up fees then those who do not join will be able to compete very strongly for market share via marketing and advertising spend. Given the evidence referred to above, it is probable that this marketing advantage will more than offset any loss of business from sitting outside the protocol. The danger is that a protocol will fail if providers have no commercial incentive to join.

7. One idea mooted is to get a commitment from creditors to pay "fair share" to all providers who adopt the protocol. This would give a significant point of difference for consumers, increase the rate at which debts were repaid (since the "fair share" rate would be set at below current fee levels) and give providers who then chose to sit outside the protocol a real difficulty in demonstrating that their advice was in the best interests of their clients (which is a requirement of the OFT's *Debt Management Guidance*). This would though be dependent upon gaining industry-wide support. There is, however, an opportunity for Government to encourage (and potentially mandate) such an approach via an amendment to the Financial Services and Markets Act 2000

1 http://www.oft.gov.uk/about-the-oft/legal-powers/legal/cca/debt-management#named5

2 Consumer credit and personal insolvency review: summary of responses on consumer credit and formal response on personal insolvency—July 2011.

3 Consumer credit and personal insolvency review: summary of responses on consumer credit and formal response on personal insolvency—July 2011.

4 OFT Debt Management Guidance Compliance Review http://www.oft.gov.uk/shared_oft/business_leaflets/credit_licences/OFT1274.pdf

contained within the Financial Services Bill. The 2000 Act already requires the Money Advice Service to take on and deliver the co-ordination and provision of debt advice.

Impact of the Financial Services Bill

8. The Financial Services Bill seeks to clarify the role of the Money Advice Service and explicitly includes debt management services within its remit:

Section 3R

(4) *The consumer financial education function includes, in particular—*

……….

(f) *assisting members of the public with the management of debt;*

(g) *working with other organisations which provide debt services, with a view to improving—*

(i) *the availability to the public of those services;*

(ii) *the quality of the services provided;*

(iii) *consistency in the services available, in the way in which they are provided and in the advice given.*

(5) *In subsection (4) "debt services" means debt advice or assistance with the management of debt.*

9. These changes, if enacted, would not require levy-raising powers to be used for the purpose of funding DMPs, but could be used to send a clear signal to stakeholders that it would be a straightforward and easily introduced alternative to voluntary agreement. If this lever is used effectively then we could quickly arrive at a situation where agreement is reached by the main providers and creditor trade bodies to introduce a protocol incorporating mandatory "Fair Share Contributions" (FSC) for protocol providers (who would be prevented from charging any additional fees). The attraction for organisations not already operating that model is that it would give them a clear point of difference and would allow them to compete alongside existing FSC providers. It seems probable that enough fee-charging debt management companies would see this as sufficient incentive to join and give the initiative a critical mass. Similarly it must be possible for creditors to influence a protocol strongly enough to ensure that:

— The scheme properly aligns the interests of providers with consumers and creditors (the fastest reasonably affordable repayment of debt with sufficient support to ensure the arrangement is sustainable).
— There is a sufficiently robust external audit to ensure compliance and confidence in the provision.
— Liquidation of debt is faster as a result of setting the FSC rate below current fee levels.
— Non-participants can be marginalised sufficiently to make it untenable to operate outside the protocol.

10. Given the likely increase in the number of overindebted consumers who will seek advice this year and the clear benefits of agreeing a better way of dealing with their debts, the DMP protocol group has a window of opportunity to bring about a valuable change. The likelihood of this change being brought about will be much enhanced if the proposed changes to the 2000 Act are implemented as currently drafted.

11. Although enactment of the Financial Services Bill as currently worded would give Government a useful lever to influence change via a non-statutory route Payplan would also encourage use of the opportunity this draft law presents to amend other primary legislation to make a minor change to Part 5 ("Debt management and relief") of the TCE Act 2007. The annex to this Memorandum sets out the minor change necessary (including the detailed amendment itself) to allow a statutory debt management scheme to be effectively implemented if the voluntary route proves unsuccessful. Indeed, the very existence of such a measure on the statute books would also serve to focus the minds of providers in the sector that the Government stands ready to intervene statutorily and immediately if they fail to make the non-statutory route work.

Annex

Proposed change to section 124 of the Tribunal Courts and Enforcement Act 2007

As currently drafted, section 124(1) of the TCE Act 2007 provides—

> *"The operator of an approved scheme may recover its costs by charging debtors or affected creditors (or both)."*

and Section 124(2) provides:

> *"costs means the costs which the operator incurs, taking one year with another, in connection with the approved scheme, so far as those costs are reasonable"*

It will be seen that this would permit charging models in which costs are recovered from either the debtor or the creditor, but it is understood that there is some ambiguity over the use of the word "costs", in particular whether that permits the making of charges which include a reasonable level of profit or whether it is limited to recovery of actual costs excluding any element of profit. Although there is a charitable sector, it is very small and unlikely to be able to cope as the sole providers of DMPs and there is clearly a market need for the fairshare model.

In these circumstances, the sole amendment which Payplan would suggest to the primary (though as yet unimplemented) legislation would be to clarify the provisions relating to costs in the following manner:

Section 124(1) should be amended to provide:

> *"The operator of an approved scheme may recover its charges by charging debtors or affected creditors (or both)."*

and section 124(2) should be amended to provide:

> *"charges means the costs which the operator incurs, taking one year with another, in connection with the approved scheme, along with any charges made by the operator, so far as those costs and charges are reasonable."*

If this route of amending the TCE Act 2007 were taken, any Regulations that were eventually made under it (if deemed necessary), so far as they related to charges and costs could simply provide:

"Charges by approved operators—

(a) An approved operator shall not impose charges by way of costs to the debtor and/or affected creditor under section 124(1) of the Act which are greater than either:

1. [ ]% of the relevant debt; or
2. £[ ], whichever is the smaller."

Alternatively, the Regulations could make provision for specific fees and charges according to a table of fees set out in a Schedule to the Statutory Instrument. This would allow them to be varied periodically to account for changes in the cost of providing debt management services.

Detail of proposed draft amendment to the Financial Services Bill

Page 163, line 19

After Clause 93

Insert the following new Clause—

"Amendments of Tribunals, Courts and Enforcement Act 2007

Amendments of Tribunals, Courts and Enforcement Act 2007

(1) Section 124 of the Tribunals, Courts and Enforcement Act 2007 (charges by operator of approved scheme) is amended as follows.

(2) In subsection (1) for "costs" substitute "charges"

(3) In subsection (2)—

(a) for "costs", in the first instance, substitute "charges",

(b) after "scheme," insert "along with any charges made by the operator", and

(c) after "those costs" insert "and charges".

February 2012

Memorandum submitted by Association of Independent Financial Advisers (AIFA) (FS 03)

1. The Association of Independent Financial Advisers (AIFA) is the representative body for the IFA profession. There are approximately 16,000 adviser firms that employ 128,000 people, and turnover is estimated at £6.5 billion (including £4.5 billion from life policies, £1 billion from fund management and £1 billion from mortgages and general insurance). Around 20% of the UK population regularly use an IFA, with c 45% consulting one from time to time.

2. Membership is voluntary and on a corporate basis. IFAs currently account for around 70% of all financial services transactions in the UK (measured by value). As such, IFAs represent a leading force in the maintenance of a competitive and dynamic retail financial services market.

Introduction

3. AIFA's view primarily focus on proposals in relation to the Financial Conduct Authority (FCA) and the key policy issues as relevant to the IFA profession.

4. AIFA support the Government's overall objective to increase financial stability and improve customer protection, but we are increasingly concerned about the overall cost burden placed on our member firms. The current structure and its accountabilities does not provide for an aggregate view of the cost of all regulatory

entities on smaller firms. AIFA are fearful that the costs of regulatory reform are not fully recognised and predict ever increasing cost pressures befalling our members as a consequence. An example of this is the FSA have just announced a 15% increase in costs, on top of a 10% increase the previous year. At the same time, the FSCS is taking aggressive action to recover costs after the collapse of Keydata (a regulated firm that offered investment products) from IFAs that sold the firm's products. FSCS have already levied IFAs collectively, as normal, but in pursuing the individual firms, they are likely to put many out of business. The cumulative impact of the burden of FSA fees and of FSCS recoveries on the IFA sector is further increased by businesses in the sector failing or exiting, as the cost is spread amongst fewer firms. And there is no consideration of the total burden placed on firms.

5. AIFA is concerned that the increasing cost burdens will lead to an increasing number of advisers to leave the industry altogether. This will result in fewer opportunities for consumers to access financial advice and undermine the Government's wider public policy agenda to help consumers re-engage with their long-term financial well-being. Reduced access to advice also translates into reduced access to products and services from which consumers can and have derived significant benefits. AIFA believe there should be a controlled approach to cost increases and full recognition of the affect increasing costs have in regard to the number of firms, the access to advice, competition and consumer choice and cost. At a time when the public sector as a whole have been restricted, the FSA has awarded itself double digit increases to its budget. AIFA suggest that the FCA should have regard to the total cost burden on financial services firms and that future fee rises for the FCA should be limited. This could be achieved through a cap (for example limited to CPI + 1% or to the rate of increase in public spending) with larger increases needing Treasury approval.

6. We are encouraged by the Government's recognition of the required cultural change necessary in order to ensure that the FCA is effective and operates in a manner that commands the respect of both consumers and firms. AIFA believe that in order to ensure this cultural change is achieved and costs are held in check, it is important that the checks and balances to hold the FCA and PRA to account are properly monitored. AIFA believe that it is not adequate to state that a culture of transparency and openness will be adopted, but there needs to be an explicit process setting out how this will be realised and measured. This plan needs to address the leadership, staffing and experience. Success will lie in both the FCA and industry recognising the value of a collaborative arrangement on the basis of open consultation and clear dialogue. This should yield a regulatory dividend for firms if compliance is easier to understand. The new regulator will not be successful if simply seen as an extension of the previous. Measures of a change in approach, attitude and hence effectiveness, should include a rationalisation of the Handbook (a particularly large and complex set of rules that promotes a tick box culture and necessitates a large compliance industry—reducing its length would make a considerable contribution to the Government's Better Regulation agenda) and outcomes for consumers (are they able to access the products they need—has progress been made in improving take up of savings, protection and pensions; do they have confidence in buying financial products; do they have the necessary support to buy the right products for their needs). The cultural change needs to be real, observed and measurable. To ensure this happens, the Government should commit to reviewing progress after two years.

Accountability

7. Regulation without the necessary checks and balances can lead to poor decision making and costly mistakes. Historically the regulator has heavily relied on systems of internal self-assessment that have not always proved adequate. AIFA endorse the FCA's direct accountability to HMT and welcome the greater role for the National Audit Office (NAO) and Public Accounts Committee in reviewing the new regulatory structures including the responsibility to audit the FSCS, FOS and CFEB. On paper, the FSA operates under a framework of checks and balances, but in practice the FSA has had a free hand. AIFA would like the Government to commit to reviewing the effectiveness of the new oversight arrangements within two years, to see whether it is delivering the right outcomes for consumers (see above) and serving customers' interests in facilitating a vibrant financial services sector.

8. We fully support the new statutory footing of the Smaller Business Practitioner Panel, the maintenance of the Practitioner and Consumer Panels, and the creation of the Markets Panel. However, we suggest that the operation of the FCA would be further enhanced by giving the same statutory footing to the Regulatory Decisions Committee (RDC). The RDC was established following an in-depth FSA review recommending that investigation and recommendation functions are carried out separately from the taking of decisions and issuing of statutory notices. The review was commissioned after failures of the previous system. The RDC represent the public interest and are drawn from practitioners and non-practitioners. As the Bill is drafted, there is no check on enforcement activity, as was deemed appropriate by the FSA's own review. The proposed s 395 only requires the agreement of a person "not directly involved in establishing that evidence". Presumably this could be just a member of the team not involved in the investigation but might be accountable to the enforcing manager. Hardly a material check to the enforcement process. The RDC has played an important function in improving the quality of enforcement actions and its role becomes even more relevant when we consider the proposed FCA pre-emptive powers in relation to warning notices. The Regulatory Decisions Committee should be put on a statutory footing.

FCA Powers

9. While AIFA support the FCA's requirement to consult on the publication of warning notices, we are concerned about the effect they will have on firms' and individuals' reputation. We recognise that early publication may be of benefit to consumers but given that in two-thirds of cases potential enforcement is not publically "concluded", it results in firms bearing an inaccurate unlimited on-going risk of "pending action" without any way of publically confirming their innocence. We think this may severely damage the reputation and financial stability of smaller firms, who will be presumed guilty without investigations being formally concluded. AIFA believe that a more appropriate balance needs to be achieved between early intervention and the treatment of firms. We recommend that the FCA introduce a clear process that will make explicit that firms are exonerated when it is concluded that no wrongdoing has taken place. AIFA believe we need further clarity and reassurance on how these powers will be used and how a fair balance will be achieved.

Long-Stop

10. AIFA support the need for a cap on adviser liabilities in-line with other professional advice firms. The lack of a limit on the time a complaint can be brought against an adviser means that firms face an open ended liability. This means that firms, particularly smaller ones, have the burden of making provision within their accounts for the increasing risk of complaints as well as the proposed increases to capital-adequacy provisions. Additionally, it impedes investment, recruitment and retention in the profession, thereby undermining the further development of a sustainable, competitive and accessible advice sector.

11. AIFA believe an appropriate solution would be the introduction of a longstop on the time within which a complaint can be brought. The FSA has long promised to consider the issue of IFA liability and a clear, fair and workable way forward, but this has not been taken forward. We recognise that any limit needs to provide the right balance with consumer interests. We believe that a 15 year limit would strike a balance between the ability of individual customer's ability to bring a complaint and supporting the development of a sustainable, competitive and accessible advice sector. AIFA research shows support for this from consumers, who favour such a move: 73% of consumers believe that there should be some time limit for advisers to be legally responsible for advice given, of which 23% believe that the responsibility should end when the relationship between the client and IFA ends (*YouGov,* September 2007).

12. AIFA are positive that bringing financial services into line with other advice sectors would also encourage consumers to take more responsibility for their financial well-being, thereby supporting one of the Government's key agenda items. We believe that whilst in some cases additional responsibility may deter consumers, many will engage with financial services with greater attention to their requirements and the value of products and services.

Europe

13. AIFA remain concerned regarding the incompatibility between the proposed twin peaks approach separating conduct and prudential regulation, and the European sectoral approach comprising three European Supervisory Authorities each with prudential and conduct remits. AIFA supports the Government's commitment to maintaining clear communication channels with Europe but suggests that a coordinated approach is formalised to prevent significant confusion, duplication and cost inefficiencies.

February 2012

Memorandum submitted by Intellect (the trade association for the UK technology industry) (FS 04)

CRITICAL OMISSION FROM THE FINANCIAL SERVICES BILL:
REDUCING THE OPACITY OF THE FINANCIAL SYSTEM

Purpose of this Briefing

Intellect, the trade association for the UK technology industry, believes that there has been a significant and potentially dangerous omission from the text of the Financial Services Bill, which the House of Commons Standing Committee is now considering.

The Government has failed to include a crucial recommendation put forward by the Joint Select Committee on the Draft Financial Services Bill in the final text that was published on the 27 January. Specifically that:

> *"The Bill should be amended to place a duty on the Bank of England (or its subsidiary the PRA) to develop information standards for the UK financial services industry and to report regularly on progress in improving these information standards in order to support financial stability."*
>
> p 58, *Final Report,* Joint Select Committee on the Draft Financial Services Bill

This recommendation is a response—acknowledged and addressed by the equivalent legislation in the United States (the Dodd-Frank Act which created the Office of Financial Research)—to the frequently lamented opacity of the financial system amplified by deficiency in the standards and timeliness of reporting data that banks submitted to regulators before, during (and indeed since) the financial crisis. Data, and the information gleaned from it that informs actions of both banks and regulators, underpins the entire financial system and every firm therein. Bad data equals bad decisions and this is something that was painfully apparent over the course of the financial crisis where regulators were not able to interpret the mass of often meaningless and inaccurate data submitted by banks into actionable information.

The reporting data that reflected the exposures and positions of every bank was not sufficiently granular, accurate or standardised enough for regulators to either identify the build up of the crisis in the first place, nor act quickly or decisively enough to limit its worst effects. In over three years since the crisis, there has been virtually no progress—most notably by UK policy makers and regulators—in addressing this glaring failure of financial supervision and corporate governance.

As the Government has set out in recent weeks, limiting the wider "fall out" on the economy of the Financial Policy Committee's (FPC) interventions is a crucial element of the new regulatory regime. Given the current opacity of the financial system and the poor standards of data that the FPC will be basing its decisions on if there is no change, there is a significant chance of collateral economic damage from untargeted, blanket market interventions based on inaccurate information. Manipulation and modelling of data is crucial to allowing the FPC to not only predict future risk events and act before the worst effects are felt, but also, it will allow it to bury down into the cash flow of an instrument or investigate a specific "corner" of the financial system. This would allow the FPC to target its interventions more accurately—reducing the wider impact of intervention on the economy. This will not be possible unless banks start to produce and submit standardised and granular risk data.

As things stand the new regulatory authorities will not be equipped to form an accurate assessment of the current and future risks to the financial system or individual financial institutions and therefore they will not be in a suitable position to make effective, targeted and timely judgements/interventions—as was the case in the financial crisis. The US Treasury Department and Congress have appreciated this reality and acted accordingly to address this failing. However, it unfortunately appears that the Government and the UK regulatory authorities have yet to do so. By omitting this recommendation, it demonstrates a presumption that "someone else will deal with it"—a dangerous oversight when the effectiveness of the rest of the Bill's provisions rest on the ability of regulators to take a holistic view of the financial system.

Challenging the Government's Reason for Exclusion of the Recommendation

Intellect acknowledges the Government's response to this recommendation (published on 1 February 2012) stating that the PRA and currently the FSA already has the power to make such rules, under the direction of the FPC. However, the financial crisis exposed the poor state of the risk data collated by banks and how the regulatory authorities were not able to act decisively to limit the worst effects of the financial crisis as a result. It is therefore particularly worrying that this clear deficiency of the system has not been addressed over three years since the height of the crisis. A report published in December 2010 by the Senior Supervisors Group (of which two members are FSA representatives) acknowledge the inability of banks to provide timely and granular risk data to regulators. As such, Intellect would argue that the FSA has not exercised this power to date.

Similarly, the recent publication of the Bank of England's paper *Instruments of Macroprudential Policy*—setting out proposed tools for FPC market intervention—demonstrates a significant element of "cart before horse". Intellect believes that in order for the FPC to effectively and decisively exercise these tools to mitigate systemic risk, it needs to first have a macro view of the financial services ecosystem. The current lack of transparency across the system, the complexity of instruments and service/transaction mechanisms means that regulation is, to all intents and purposes, being applied blindly.

The Financial Services Bill does not address this deficiency and the effectiveness of the rest of the Government's reforms will be potentially undermined as a result. Intellect believes that there should therefore be a commitment by either Government or the regulatory authorities to address this issue as a priority—as it has, to date, been left unaddressed by all parties. As set out by the cross-party Joint Committee, the Financial Services Bill would appear to be the ideal vehicle to facilitate this crucial requirement.

Why is this Amendment Important?

Ultimately because the UK regulatory authorities have not fully acknowledged that this was a supervisory failing exposed by the financial crisis and which therefore needs to be addressed as part of the wider reform of the system.

And

The opacity of the financial system is good for business, shedding light on it may be deemed to be counter to the banks' own commercial interests. The poor standard of data within banks will require significant time and resource to rectify with limited immediate return on investment for banks. Therefore a mandate is required for it to happen.

Problem:

The 2008 financial crisis exposed the weakness of the UK's financial services regulatory framework, in particular the asymmetry of information between the regulators and financial services providers. Specifically:

— The banks themselves were either not able or not willing to prioritise the reporting of enterprise risk to board level. Bank's failed to collate and interpret risk data of suitable quality so that they could identify the risk that they were holding across their disparate operations. That they were taking excessive risks during the economic boom has, in hindsight, exposed this failure of corporate governance.

— Regulators received significant amounts of data from banks but were unable to interpret it, were unable to make informed judgements and therefore unable to make decisive interventions in the market. That there was no standardised format to this data meant that in trying to build up an holistic picture of the financial system, regulators were not only trying to compare apples and pears, but oranges, bananas, and so forth.

"The problem is that every firm, indeed virtually every division and trading desk, has developed piecemeal approaches to the recording of financial information. Regulators can indeed ask for data dumps, for multi-Gigabyte files that contain all exposures. But even when regulators have the requested information they can do nothing with it. Information without uniform data standards is simply not accessible."

Professor Alistair Milne, Loughborough University School of Economics & Business

Result:

The financial crisis was not identified in good time and action taken by regulators (and indeed banks themselves) to prevent it. This was a massive failure of corporate governance and was ultimately responsible for the depth of the crisis and the depth of the public bail out of stricken banks.

The Government had to step in and save RBS and HBoS without full knowledge of the risks that the banks faced, and an accurate assessment of what impact their collapse would have posed to the financial system as a whole. Similarly in the US, a slowed response time resulting from poor actionable data meant that regulators had to choose between saving one of Lehman Brothers and AIG. The decision was made to let Lehman Brothers fail, demonstrating the inability within the regulatory system to react quickly and effectively. It has taken three years so far to untangle who is owed what from the collapse of Lehman Brothers due to the complexity of its holdings and relationships with other parties.

So what?:

Whilst there has been progress to address poor data quality and standardisation in the US (OFR–Dodd-Frank Act) and international efforts to set standards for a Legal Entity Identifier, there has been very little progress on a UK level since the financial crisis as part of wider reforms of the financial services industry—which poses questions of the UK Government's and regulatory authorities' appreciation of the operational realities of the financial system. The Bank of England has begun consulting on what tools it will require to intervene in the financial system—but there is a significant element of "cart before horse" here. These tools will only be effective if the intervention is timely and based upon accurate and standardised data gleaned from banks. The risk of negative economic effects resulting from poorly targeted interventions will remain for as long as the regulators are unable to drill down into the cash flow of an instrument or accurately identify complex linkages between firms across the financial system.

As things stand, the Bank of England will not be receiving accurate information from the banks on their own health and risk positions, and therefore the Financial Policy Committee's (FPC) actions to maintain financial stability will be based upon information of questionable quality and integrity. There has been significant retrospective learning about the causes of the financial crisis based on data that has now been collated (slowly) and interpreted over three years on from the onset of the crisis, but this does not help in the identification of imminent or future threats across the financial system and empowering the FPC to take actions to mitigate them in a timely and targeted manner.

Solution:

Increasing the transparency of the financial system through more granular and standardised data at individual institutional level that will afford regulators an accurate, macro view of the system when this data is collated and analysed.

This standardisation of data will allow the Bank of England to identify discernable groupings of risk within the financial system, then allow it to identify correlations across any data elements across the system; which in turn will allow for the visibility of patterns that can point towards specific risks. This "critical chain" will facilitate root cause and hinge factor detection as the system evolves so the regulator is able to plan, mobilise and implement interventions based on accurate data that can be manipulated and modelled to give numerous perspectives of the financial system.

Ultimately, this may facilitate a forward-looking systemic risk "early warning system" based upon a dashboard that highlights key changes in the characteristics of the financial system; through a "system of systems" that collates standardised data from across disparate individual financial institutions and ultimately uses predictive analytics to identify future market "events".

By reducing the opacity of the system and exposing the complex linkages between institutions, this tool will allow the FPC to more confidently require financial institutions to shrink in size, become less entwined, reduce their dependency on short-term debt, revalue their assets, or set aside additional capital, among other options. *ie* the macro prudential tools that the Bank of England have already set out. Under current conditions, the risk of wider (unintended) economic fallout as a result of FPC market interventions is much greater as there is not the granularity of data to target such interventions on specific instruments or "corners" of the market.

However, this is all underpinned by the critical need for accurate data. Herein lies the current challenge for the House of Commons—to ensure that the regulatory authorities have the means to prescribe what data they need, and that banks are obliged to provide this. It is disappointing that the Government has chosen to ignore this, despite the recommendations of Parliamentarians in both Houses, but the legislative scrutiny of this crucial Bill presents an opportunity to redress this. It is essential for the effectiveness of the proposed regulatory regime, that the Financial Services Bill provides the Bank of England with the statutory obligation to develop uniform standards for risk data within banks, and that these standards are enforceable at a bank and financial institution level.

Case Study—The US Taking the Initiative—The Office of Financial Research

In the United States the OFR has been established within the US Treasury Department as a result of the Dodd-Frank Bill. Its remit is to improve the quality of reference data available to policymakers, facilitate more robust and sophisticated analysis of the financial system and it has the means to enforce individual institutions therein to do so.

Often compared to a storm-warning system, the OFR through its two units, a Data Center and a Research and Analysis Center, can continually gather up and analyse detailed financial information collected from a variety of banks and other financial firms. The OFR will share this with the Financial Stability Oversight Council and its member agencies so they can act as the storm approaches to prevent, prepare and intervene. As a result, for the first time it is hoped that regulators will have the necessary tools to evaluate the stability of the entire financial system, not just individual banks. Moreover, instead of outsourcing to the financial firms themselves, as was done on occasion in the past, regulators may control the data and possess the capability in-house to make independent determinations.

In effect, the OFR is permitted by law to demand data from financial companies including banks, hedge funds, private-equity firms and brokerages. It would be able to track information such as counterparties for credit-default swaps and would, crucially, afford regulators the sort of system-wide overview (including darker parts of the market) that will allow it to identify when and where there is a risk to financial stability. The OFR also has the authority to coerce financial institutions to standardise data types and data formats to facilitate its wider role.

All this, and the fact that the OFR has recently started defining reporting standards for the financial community, puts it way ahead of the FPC in terms of establishing tools to head off the next financial crisis.

> *"The OFR will enable regulators and the Treasury to better understand the complex financial products, more effectively uncover fraud, better monitor risks from large financial institutions, and for the first time be able to see the critical linkages between important institutions in the market . . . Only the most ardent opponent of regulation would oppose providing regulators and policy makers with the data, research and monitoring tools needed to provide for the safety and security for our financial markets. The cost of regulators continuing to fly blind is a cost that the US taxpayers cannot afford."*
>
> Testimony Before the Subcommittee on Security, International Trade and Finance—Committee on Banking, Housing and Urban Affairs; United States Senate; "Providing Financial Regulators with the Data and Tools Needed to Safeguard Our Financial System";
> *Allan Mendelowitz* and *Professor John Liechty*

As the Government also set out in its response to the Joint Committee, an equivalent of the OFR would not be appropriate for the proposed UK regulatory regime as the FPC will have the power to set data standards. Intellect acknowledges that whilst establishing a carbon copy of the OFR in the UK may not be appropriate, the important point here is that setting up the OFR was an acknowledgement by the US Treasury Department that there remained an unaddressed deficiency exposed by the financial crisis, that it was a potential threat to the effectiveness of wider reforms and that, crucially, this deficiency would not simply "sort itself out". The financial crisis exposed the same deficiencies in the UK that it did in the US, but the difference is that there has been no action taken to plug this gaping hole in the UK and no commitment, by Government or regulator, that it will be.

Annex

TESTIMONY

Intellect is not alone in noting the lack of transparency of the financial system, how this contributed to the financial crisis and to the depth of the economic turmoil since, and how this needs to be addressed as a priority. Many commentators from across the financial system have made public remarks on this issue, a small cross section of which is below:

> *"The events of the most recent financial crisis have laid bare the dire consequences that can flow from poorly understood and ineffectively regulated financial institutions and markets. In response to the crisis, a lot of attention has been paid to how to strengthen the legal authorities and organizational structure of the financial regulatory community. Unfortunately, far less attention has been paid to what data and analytical capability is needed to enable regulators to use those new powers effectively. Data and analytics are not the stuff of headlines and stump speeches; however, when they are deficient, they are the Achilles' heel of financial regulation. Unfortunately, we have ample evidence that the recent crisis was due in part to a lack of appropriate data and analytic tools."*

Testimony Before the Subcommittee on Security, International Trade and Finance—Committee on Banking, Housing and Urban Affairs; United States Senate; "Providing Financial Regulators with the Data and Tools Needed to Safeguard Our Financial System"; *Allan Mendelowitz* and *Professor John Liechty*

> *"The recent financial crisis highlighted shortcomings in policymakers' ability to measure systemic risk. Gaps are evident in both the analytical framework and the available firm-level and aggregate data that policymakers and market participants use in making decisions. These gaps hinder market participants in pricing and managing risk and policymakers in monitoring and responding to vulnerabilities. This experience should prompt improvements in macro surveillance and data collection."*

81st Annual Report (June 2011); Bank for International Settlements

> *"Whereas financial markets have evolved over the past decades to operate globally through IT-intensive processes and networks data standardisation has lagged behind, hindering market—and often even firm-wide—data aggregation, analysis and operations, and reducing the transparency of financial transactions."*

Hökmark report on Global Economic Governance (October 2011); Committee on European and Economic Affairs in the European Parliament

> *"The problem is that every firm, indeed virtually every division and trading desk, has developed piecemeal approaches to the recording of financial information. Regulators can indeed ask for data dumps, for multi-Gigabyte files that contain all exposures. But even when regulators have the requested information they can do nothing with it. Information without uniform data standards is simply not accessible."*

"The Fall of the House of Credit"; *Professor Alistair Milne,* Loughborough University School of Economics & Business

> *"Both banks [RBS & HBOS] found it difficult to provide the Treasury with appropriate and robust data on their assets. We found this alarming. It places a question mark over the standards and practices of the banks themselves, and whether or not there was effective oversight by regulators and the banks' own auditors."*

31st Report: HM Treasury—The Asset Protection Scheme (April 2011); House of Commons Public Accounts Select Committee

Intellect would urge Members of Parliament to consider the economic importance of equipping the new regulatory authorities with the correct tools for them to do their job, and to enforce the banks to truly reform the way that they operate so the chance of another financial crisis (and indeed the following economic fallout) can be significantly reduced. Intellect believes that the Financial Services Bill should be amended to include this provision—as the cross party Joint Select Committee had initially recommended.

ABOUT INTELLECT

Intellect is the UK trade association for the IT, telecoms and electronics industries; industries that generate around 10% of UK GDP and 15% of UK trade. Our Members include blue-chip multinationals as well as early stage technology companies and play a crucial role in virtually every aspect of our lives. Intellect articulates a cohesive voice for these industries across all market sectors, and is a vital source of knowledge and expertise on all aspects of the technology industry.

Intellect's Financial Services Programme brings together over 170 suppliers of information systems, services and consultancy to the banking and insurance sectors. The relationship between the financial services industry and the technology sector is one of fundamental importance. As the Office for Fair Trading has recently stated, "IT systems are the backbone of retail banking activities and are essential to the safety and resilience of financial systems". Technology not only plays a critical role in the functioning of the full spectrum of financial services, it is a hugely important factor in ensuring that the individual institutions within it can operate more responsibly and remain competitive in the global marketplace. The right technology can help depress costs, reduce risk and increase the confidence of lenders and investors, all of which are of paramount importance in the current economic environment. Applied inappropriately or to the wrong ends and it can contribute to systemic risk, lead to reduced inward investment and ultimately have a detrimental effect on the economy.

Notices of Amendments

Intellect, the trade association for the UK technology industry put forward a case to Members of the Financial Services Bill Standing Committee to support a number of amendments put forward by the member for Nottingham East, Chris Leslie MP and the member for Kilmarnock & Loudon, Cathy Jamieson MP.

Specifically, these amendments relate to the standards of data that will be collected by the proposed Prudential Regulatory Authority(PRA), which in turn would then be available for the Financial Policy Committee (FPC) to base its market interventions on—*ie* its financial stability role. Intellect would argue that by proscribing the data that banks must produce, it will reduce the opacity of the financial system and increase the effectiveness and reduce the risk of unwanted economic fallout, of regulatory market interventions. For reference, the relevant amendments are attached to this email and are numbered 38, 88 and 89. A briefing paper outlining Intellect's case is attached to this email and provides testimony from a number of stakeholders across the financial system.

As things stand the new regulatory authorities will not be equipped to form an accurate assessment of the current and future risks to the financial system or individual financial institutions because of the poor standard of reporting information that banks submit to regulators. The result is that the regulatory authorities (and the Financial Policy Committee in particular) will not be in a suitable position to make effective, targeted and timely judgements/interventions—as was the case in the financial crisis.

Whilst Intellect acknowledges the Government's position, re-iterated in the Standing Committee session of 21 February by the Financial Secretary to the Treasury, that the Financial Services Bill already provides for "the power for the FPC or the Bank to request information in pursuit of financial stability" (page 13 of the Bill and new section 9V to the Bank of England Act 1998—"Directions requiring information or documents" Subsection (2)), we believe that this stance overlooks the key point of an argument espoused by numerous organisations across the financial ecosystem—that the information requested by the FPC from the PRA (or the FCA) will be based upon poor quality data taken from individual banks, that does not accurately reflect the true risk positions of individual financial institutions. In short, it is all very well empowering the regulators to request information from wherever it feels it is necessary, but if this information stems from data that is neither granular, timely, nor accurate—it will not allow the FOC to effectively intervene in the market to head of systemic risks.

Under current conditions, the risk of wider (unintended) economic fallout as a result of FPC market interventions is much greater as there is not the granularity of data to target such interventions on specific instruments or "corners" of the market. The US Treasury Department and Congress have appreciated this reality and acted accordingly to address this failing in the Dodd-Frank Bill by creating the Office of Financial Research. However, it unfortunately appears that the Government and the UK regulatory authorities have yet to do so and the current provisions of the Financial Services Bill does not address this significant oversight.

The amendments put forward on "Data Collection" will go some way to providing the statutory basis upon which reporting standards that banks must adhere to, can be set. Intellect feels that providing the regulatory authorities with the right tools to do their job is not a party political issue, but more one of necessity, common sense and economic prudence.

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Financial Services Bill—*continued*

CHRIS LESLIE MP

CATHY JAMIESON MP

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Schedule 12, page 244, line 40, at end insert—

"In section 165(A) after subsection (10) insert—

"(11) Data Collection

(a) The PRA should require the submission of reports from any PRA-authorised person for the purpose of assessing the extent to which a financial activity or financial market in which the PRA-authorised person participates may pose a threat to financial stability in accordance with the PRA's general objective. The PRA shall collect, in a manner determined by the PRA and in consultation with the FPC, financial transaction data and position data from PRA-authorised person companies.

(b) For the purposes of (a)—

(i) financial transaction data shall mean data pertaining to the structure and legal description of a financial contract, with sufficient detail to describe the rights and obligations between counterparties and make possible an independent valuation; and

(ii) position data shall mean data pertaining to data on financial assets or liabilities held on the balance sheet of a financial company, where positions are created or changed by the execution of a financial transaction and which includes information that identifies counterparties, the valuation by the financial company of the position, and information that makes possible an independent valuation of the position.

(c) The FCA shall assist the PRA in accordance with Clause 3D to ensure that the PRA is able to exercise its function as described in (a);

(d) (i) To facilitate the effective collection of data, the PRA should prepare and publish, in a manner that is easily accessible to the public and in the form of a summary or collection of information so framed that it is not possible to ascertain from it information relating to any particular person—

(1) a database detailing relevant counterparties; and

(2) a financial instrument reference database; and

(3) formats and standards for PRA data, including standards for reporting financial transaction and position data to the PRA; and

(ii) Where possible, the PRA shall co-operate with foreign regulators to the extent required to collect relevant information on PRA-authorised persons already collected by those foreign regulators;

(e) The PRA shall develop and maintain sufficient resources to review the collection of data referred to in (a) above in order to—

(i) develop and maintain metrics and reporting systems for risks to the financial stability of the United Kingdom;

(ii) evaluate stress tests or other stability-related evaluations of financial entities overseen;

(iii) investigate disruptions and failures in the financial markets;

(iv) conduct studies on the impact of policies relating to systemic risk;

(v) promote best practices for financial risk managment to PRA-authorised persons.

(f) The PRA shall publish a report which compiles the data collected in accordance with Clause (1) on a periodic basis as determined by the PRA, which shall be—

(i) made available to the public in an easily accessible medium; and

(ii) in the form of a summary or collection of information so framed that it is not possible to ascertain from it information relating to any particular person.”.”.

February 2012

Memorandum submitted by the Association of British Insurers (ABI) (FS 05)

The ABI

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

Summary

The work of the Treasury Select Committee and the Joint Committee has helpfully refined the Government’s original proposals, and there is now a broad consensus on the outlines of the new framework for the regulation of financial services in the UK. There are still some significant changes that need to be made at Committee Stage. First, we believe that the Financial Conduct Authority is being established with an unnecessarily adversarial remit, that will lead to a difficult relationship between regulator and regulated, with little benefit to the consumer. The rough edges of this remit need to be smoothed. Secondly, the framework still reflects the origins of the financial crisis in banking. The insurance industry should be adequately represented. Thirdly, the arrangements have been written on the assumption that the UK is a stand-alone jurisdiction, with the EU-related points added as an afterthought. This is an inadequate reflection of the major role that the EU plays in practice in setting standards for financial services, and the British industry would be better served by a more constructive dialogue with the EU authorities.

Key Points

1. The FCA should be working towards positive consumer outcomes, not just avoiding negative outcomes. So the FCA objectives should require it to work with the industry to promote consumer access to financial services. The PRA and FCA should in setting their rules ensure that the UK remains attractive as a location for financial services in comparison to other major jurisdictions.

2. Close co-ordination between the PRA and FCA is essential, particularly for dual-regulated firms. We welcome the greater clarity about the arrangements set out in the draft MoU between PRA and FCA although we continue to have concerns about the lack of detail in the MoU. However, there remain certain areas where improvements are needed on the face of the Bill (particularly in relation to the approved persons regime). Parliament will need to ensure that the arrangements set out in the Bill and the draft MoU actually operate in practice to ensure that firms are supervised efficiently. The respective roles and responsibilities of the FCA and the Office of Fair Trading also need to be made clear, in light of the FCA's new role to promote competition in financial services.

3. Good quality regulation is essential. We need supervisors with a background in regulated firms, and policy-makers with appropriate negotiating and technical skills to represent the UK at EU level.

4. We are concerned that in relation to the EU the overriding priority of the British authorities should be to ensure that the "European rulebook does not limit their discretion. This approach is not consistent with the role of the ESAs as set out in the EU Regulations establishing them, which set out the circumstances in which the ESAs can overrule national authorities, and look forward to deeper co-operation and supervisory convergence in the EU. Further, this approach is not shared by other national authorities, and will make them reluctant to follow the UK's lead on substantive policy issues. It can already be seen to be leading to the isolation of the UK in EU discussions. British companies operating in the Single Market would be better served in EU negotiations by a constructive dialogue.

5. We generally welcome the proposal to set up a separate prudential regulator and, in particular, the recognition of the need for a separate insurance objective—this will enable the different business model of insurers to be taken into account and for insurers to be supervised by specialist regulatory staff. We also agree with the Government's proposal that the main responsibility for the regulation of with-profits policies should lie with PRA.

6. However, the accountability arrangements for the PRA remain weak and need to be improved. In particular we believe that there is a need for the consultation requirements on the PRA to be included in the Bill rather than left to the discretion of the PRA itself.

7. The insurance industry must be properly represented at the Bank of England and the PRA. This needs to be reflected at PRA Board level and with the membership at the Financial Policy Committee.

8. Wholesale markets must not be the "poor relation" in the FCA. The insurance and investment industry does not just operate in the retail market (*ie* where products are sold to customers), it also operates in wholesale markets. The wholesale markets need quality not quantity of regulation. Regulators need to understand markets and their complexities and the nature of financial innovation.

9. The insurance industry would like to see stronger accountability of the Financial Ombudsman Service. We support a low cost adjudication service for customer complaints. The respective roles of FCA, FOS and Courts should be clear and we need external scrutiny of effectiveness and efficiency of FOS. We also need better regulation of Claims Management Companies, which are fostering a compensation culture.

10. We support the role of UK Listing Authority (UKLA) being retained by the FCA alongside its other responsibilities for markets regulation. However, we do think that the current formulation under the 2000 Act, where the relevant powers are given to the competent authority and the FSA is in turn designated as the competent authority, should be retained. The role of the UKLA is qualitatively different from the role of the FCA as regulator of entities and individuals in financial services. By contrast, the Listing Authority's remit extends to all listed companies and other public issuers of securities, and this should continue to be reflected appropriately in the legislative framework.

Proposed Amendments

The ABI has separately sent members of the Committee our proposals for a number of amendments to the Bill which we believe improve the Bill and address a number of our key points.

Our most significant proposals for amendments relate to the FCA. In particular we believe that the objectives of the FCA should be amended to ensure that it improves access by consumers to financial products and that the regulatory principles applying to both PRA and FCA should include a "have regard" to the competitiveness of the UK financial services industry. These changes will help ensure a more competitive industry able to offer appropriate products to a wider range of consumers.

We also have concerns about the proposed product intervention powers which, if they are retrained, should clearly be used only as a last resort; we believe that claims management companies should be brought within the scope of regulation; that existing powers of the Financial Services Tribunal should be retained and that the accountability of FOS should be strengthened.

In respect of PRA we have concerns about the wording of the insurance objective and about the requirements on PRA to consult with the industry (which remain deficient compared to FCA).

We are also concerned about the composition of the Bank of England's Financial Policy Committee and would suggest amendments to increase the number of independent members and ensure that these members are drawn from a wider pool of relevant candidates (including from the insurance industry).

Draft Memoranda of Understanding

Much of the Bill's provisions about co-operation between the UK authorities will be underpinned by Memoranda of Understanding (MoUs). Three draft MoUs have been published—one relating to co-operation between PRA and FCA, one on crisis management (between HM Treasury and the Bank of England/PRA) and one on international co-operation (between HM Treasury, the Bank of England, PRA and FCA). Consideration of the draft MoUs will, therefore, inform the Committee's deliberations on those parts of the Bill which relate to co-operation between the UK authorities.

The Annex to this paper sets out our comments on the draft MoUs. In general we remain concerned at the lack of detail in some areas of the MoUs.

The Bill makes provision for certain other MOUs. Those relating to exercise of powers in relation to recognised investment exchanges and clearing houses involving the Bank, FCA and PRA are important in establishing confidence in regulation of infrastructure relating to the capital markets. We consider that these should be published in draft at an early stage in the Parliamentary process to allow informed deliberation on how effectively these arrangements will work and whether other safeguards need to be incorporated in legislation.

Annex

Comments on the Draft Memoranda of Understanding

Draft MoU between FCA and PRA

1. This draft MoU sets out the relationship between the FCA and PRA. It is intended that the two supervisory bodies will operate largely separately in pursuit of their individual objectives. However, it is accepted that in certain areas there will be an ongoing need to co-ordinate and co-operate. The draft MoU appears to cover all of the relevant issues but we do have a number of concerns about it.

2. In some cases the MoU explicitly sets out which officials within the PRA and FCA will be responsible for ensuring that co-operation takes place in particular instances (for example, paragraph 19 makes clear that it will be the Board Secretaries of the two organisations which ensure that co-ordination on rulemaking takes place). However, in other areas (for example, the quarterly meetings discussed in paragraph 18) it is not made clear who will be responsible for ensuring that the arrangements are set-up and operated effectively. We believe that the MoU should be much more explicit about assigning responsibility to the relevant officials within PRA and FCA.

3. In paragraph 17 it is stated that in relation to policy and rule-making that "the regulators will seek to avoid incompatible requirements" and in paragraph 47 it is stated that "PRA and FCA will seek to avoid taking regulatory actions that are incompatible or even in conflict". This is not good enough. As drafted it leaves open the possibility that PRA and FCA could reach incompatible views. It would be entirely unacceptable for firms to be put in a situation whereby it would be impossible for them to comply with regulatory requirements because of incompatibilities between PRA and FCA: the MoU must make clear that all such differences must be resolved.

4. Paragraph 10 relates to exchange of information. It makes clear that not all information will be shared but that the regulators should share data where it is requested and each regulator should proactively offer information where it thinks that it will be relevant to the other. This puts considerable onus on each of the regulators to be aware what information the other has gathered and what information might be relevant to the other This raises the possibility that where they are not so aware (which seems more than likely given that the two authorities are independent of each other) information might be gathered separately by both authorities—at additional expense to both firms and the regulators. We would recommend that wherever possible the regulators gather information jointly and that the MoU should require details of all the information collected by each regulator to be shared so that each is aware of what the other has.

5. Paragraph 28 provides that domestic supervisory colleges will be set up for dual regulated firms where appropriate. We agree with this. The draft MoU proposes that the college should meet every six months for large firms and annually for smaller ones. While this may be appropriate for formal meetings we would expect more frequent interaction between the regulators to ensure that they properly co-ordinate their work. Paragraph

37 deals with international colleges and notes that both PRA and FCA will attend where appropriate. We would recommend that this paragraph is expended to require that FCA and PRA co-ordinate their positions in regard to international colleges so as to present a unified UK view.

6. Paragraph 49 requires FCA and PRA to meet regularly to discuss enforcement actions. We agree with this. However, the requirements are lacking in details—we think that the MoU should make clear the frequency of meetings and the officials responsible for ensuring co-operation.

7. Likewise in paragraph 60 we believe that the MoU should be more specific and provide details of the officials who will co-ordinate work with the ESAs and other international bodies.

8. Paragraph 65 requires the PRA and FCA to review the effectiveness and efficiency of co-operation. We believe that this should be amended to require the PRA and FCA to actively consider ways that they can co-operate better so as to deliver supervision in the most efficient and cost-effective way.

9. Paragraph 67 states that feedback from firms will be taken into account in assessments of how effective co-ordination has been. We welcome this. However, it is unclear how such feedback will be obtained. We propose that the MoU should set our formal requirements for the regulators to consult annually with firms (and other stakeholders).

10. Paragraphs 4 to 6 of Annex 1 to the MoU set out the proposed arrangements for approved persons. This proposes that responsibility for approving significant influence functions will be split between PRA and FCA dependent on the function. It is suggested that roles such as Chairman and CEO will be approved by PRA on the grounds that these are materially connected to the prudential soundness of the firm. We do not believe that this is an appropriate structure. Senior management roles will have significant conduct aspects as well as prudential. Therefore, we believe that these should be approved jointly by PRA and FCA as otherwise there is a material risk that conduct aspects of these roles will be downgraded.

Draft MoU on Crisis Management

11. This draft MoU sets out the arrangements, largely between the Treasury and Bank of England/PRA, for dealing with a financial crisis.

12. Our main concern is that as drafted the MoU assumes that the Treasury and Bank of England can act autonomously without significant reference to EU or other international obligations.

13. The only references to international obligations are in paragraphs 35 and 36 of the draft MoU. This section concentrates on state aid issues (and even in this respect does not make clear that decisions on state aid lie with the EU institutions).

14. We think that the draft MoU should be expanded in order to cover relations with international organisations in greater detail (including making clear those circumstances in which these obligations may constrain the autonomy of the UK authorities). In addition to the EU authorities in respect of state aid this should include the role of the ESRB and the role of international colleges (these are likely to be particularly significant for those firms designated as G-SIFIs).

Draft MoU on International Organisations

15. This draft MoU sets out the arrangements for co-operation between HM Treasury, the Bank of England, PRA and FCA to ensure that a coherent and consistent UK position is expressed in international organisations. This is particularly necessary as the proposed UK regulatory system will operate on a twin peaks system where the distinction is between prudential and conduct regulators whereas most international bodies operate on a sectoral basis.

16. The intention is to establish an International Co-ordination Committee. The draft MoU goes on to set out principles for the authorities to adhere to in co-ordinating their work. We agree with the setting up of the proposed committee and as drafted the principles appear sensible. We are concerned, however, by the lack of detail about how the arrangements will work in practice. For example, although principle d requires an authority to facilitate representation by other relevant authorities at meetings of an international body it does not explain how the UK authorities will determine when it is appropriate for an organisation other than the official UK representative to attend meetings.

17. The draft MoU focuses on the interaction between the UK authorities but we believe that it should also cover consultation with the industry. Given the importance of international rules it is vital that the industry is involved as early as possible in discussions in respect of new requirements that will impact directly on it. We have found in the past, for example in the Solvency II negotiations, that the best results are obtained where the UK authorities and the industry are able to agree a common UK line.

18. We are disappointed by the draft MoU's limited recognition of the need for constructive engagement and dialogue with the European Supervisory Authorities (ESAs). In particular, we are concerned that the MoU suggests that the overriding priority of the British authorities should be to ensure that the "European rulebook does not limit the necessary discretion." This approach is not consistent with the role of the ESAs as set out in the EU Regulations establishing them, which set out the circumstances in which the ESAs can overrule

national authorities, and look forward to deeper co-operation and supervisory convergence in the EU. Further, this approach is not shared by other national authorities, and will make them reluctant to follow the UK's lead on substantive policy issues. It can already be seen to be leading to the isolation of the UK in EU discussions. British companies operating in the Single Market would be better served in EU negotiations by a constructive dialogue, whereby the PRA and FCA would negotiate on the basis of the practical implementation and impact of EU legislation on those who will be regulated by it. It would be a mistake for the MoU to focus on the power-play between the UK authorities and the ESAs rather than on the important regulatory outcomes.

February 2012

Memorandum submitted by Fidelity Worldwide Investment (FS 06)

Fidelity is a global asset management business. We operate in 15 countries in Europe and a further nine in India and the Far East. Our UK business is a substantial component of our overall business. We manage £24 billion in the UK for private investors, pension funds and insurance companies.

Fidelity is strongly supportive of any measures which strengthen the position of consumers in the financial services market and therefore supports the underlying direction of the Financial Services Bill as it relates to retail consumers.

There is one overarching issue which we would wish to draw to your attention. This is the fact that nowhere in any of the objectives for the new regulatory bodies is there any mention of having regard to the international competitiveness of the UK's financial services industry.

The Treasury clearly has a belief that international competitiveness is a euphemism for light touch regulation. We do not believe that is so. FIL operates with regulators globally and a number can produce appropriate and tough regulations and supervision which protects investors but also does minimal damage to their country's competitive position. There must also be a strong possibility that failure to consider the international context would be more likely to lead to poorer, inward-looking regulation.

It seems to us that it would be helpful to add to the current Bill a further operational objective, for the FCA at least, which might sit as an addition to Part 1A, Chapter 1, Clause 1B (3).

(d) *the international competitiveness objective*

This should be followed by a new 1F (subsequent clauses to be renumbered).

1F *The international competitiveness objective—*

The international competitiveness objective is: maintaining the competitive nature of the United Kingdom in respect of financial services and markets having regard to best practice in international regulation and supervision.

February 2012

Memorandum submitted by Age UK (FS 07)

1. Age UK

1.1 Age UK is the new force combining Age Concern and Help the Aged. We are a national charity and social enterprise working to transform later life in the UK and overseas. Our vision is of a world in which older people flourish. We aim to improve later life for everyone through our information and advice, services, products, training, research and campaigning.

2. Summary

2.1 The Financial Services Bill makes fundamental changes to the structure of financial services regulation. Much of this change is designed to prevent a repeat of the recent financial crisis through closer attention to and earlier intervention in the financial stability of large firms and the system itself. However, financial stability is not the only issue and the successive failings of parts of the financial services industry to provide safe, fair and accessible products must not be forgotten. Both the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) have a vital role in improving outcomes for consumers.

2.2 Current regulation has failed older consumers in two main ways: (i) it has not provided adequate consumer protection, resulting in a series of waves of major customer detriment, with approximately £15 billion compensation paid to consumers since 1990;[5] and (ii) it has not ensured access to essential financial services.

2.3 We welcome the provisions in the Bill which enhance consumer protection, especially:

— the inclusion of a new operational objective for the FCA to promote effective competition in the interests of consumers;

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[5] *Financial Conduct Authority Approach to Regulation,* June 2011, para 2.4.

— proposals to enable consumer bodies to make super complaints to the FCA;

— the principle that, in all activities, the regulators should exercise their functions as transparently as possible;

— the inclusion of specific powers, for the FCA, on product intervention;

— provisions to allow the FCA to publicise details of actions taken against misleading financial promotions; and

— the strengthening of the consumer protection objective, especially in relation to the requirement on the FCA to have regard to the needs of consumers for the timely provision of information and advice that is accurate and fit for purpose.

2.4 We also welcome the change in culture starting to be shown by the Financial Services Authority and the support the Government has given to the new approach. However, we feel that in order to maintain this change this culture must be enshrined in the Bill. To do this, we believe amendments are needed to ensure:

— the FCA and Government have the tools they need to address market failure and ensure access to essential services for all consumers;

— a fair balance between the responsibilities of firms and consumers;

— recognition of the impact of PRA decisions on consumers; and

— the FCA can act confidently, swiftly and decisively.

We have outlined these in more detail below.

3. Access, Competition and Choice

3.1 *Proposed Amendment*

Part 2 Amendments to the Financial Services and Markets Act.

The Financial Conduct Authority: The competition objective.

Page 17, line 35 at end insert—

(3) In furtherance of the competition objective, the FCA shall publish, maintain and review a code (The access and choice code) setting out (amongst other things)—

(a) the approach that the FCA will take to ensure that the market provides different consumers with access to and choice about products and services that are suitable for their needs;

(b) the approach that the FCA will take to ensure that the business conduct of those providing regulated financial services continues to promote competition in the interests of different consumers over the life of any agreement; and

(c) the additional steps that the FCA may take where competition does not deliver access and choice to suitable products and service for different consumers.

(4) The Treasury may by order specify—

(a) financial needs of different consumers that are to be considered essential; and

(b) the outcomes that are necessary to demonstrate that essential financial needs of different consumers are met.

(5) Sections 138I (1)(b) and (2) to (5) and 138K do not apply in relation to rules made by the FSA if it considers that it is necessary or expedient not to comply with them for the purpose of achieving an outcome specified in an order under subsection (4) of this section.

(6) Transactional banking is an essential financial need for all groups of consumers.

(7) Where the FCA considers that it is unable to achieve an outcome specified in an order made under subsection 4, the Treasury may by order confer additional powers on the FCA or direct obligations on those providing regulated financial services to ensure that the essential needs of different consumers are met.

Purpose and argument

3.2 This amendment requires the FCA to publish and maintain a code setting out how it will ensure that competition delivers essential financial services to all consumers. It leaves social policy questions with Government, by giving the Treasury the power to specify what financial services should be considered essential and what outcomes the regulator should pursue. It gives the FCA an objective which allows it to use its existing powers to support Government policy on access to financial services.

3.3 Consumers have no choice whether to engage with financial services, but the industry has no obligation to provide appropriate services to consumers. Competition is necessary for good consumer outcomes, however experience from other sectors, such as energy, shows that it is not sufficient for all consumers. For example, in the energy sector there are various regulatory requirements to ensure that all households have access to energy. Certain financial services, *eg* transactional banking, are now effectively essential for participation in society. However 4% of households including someone aged over 85 are without a bank account.[6] And at least as disadvantaged are those who appear to be banked but who can't actually use their accounts. Almost one fifth of people over 65 with a bank account use someone else to access their day to day spending money[7] and 24% of people aged over 65 find it difficult to get to a bank branch.[8]

3.4 As currently drafted, the Bill does not enable either the FCA or the Government to take steps to ensure positive outcomes for consumers where competition has failed. In order to complete the vision of a competitive financial services market working in the interests of all consumers the competition objective should be amended to give the FCA the mandate to use its existing powers to support the Government's social policy agenda.

3.5 A separate, more comprehensive briefing on this amendment has been circulated to all Committee members jointly by Age UK and Citizen's Advice.

4. Consumer Responsibility

4.1 Although the general principles are not intended to place burdens or requirements on consumers or firms directly, the principles will determine the level of protection afforded consumers by the regulator and so in large part determine the balance of responsibilities between firms and consumers.

4.2 The current principle that consumers have "responsibility to look after their own interests"[9] does not reflect the reality of the imbalance of power between consumers and firms and complexity of decision making in this market. In order for consumers to make good decisions they need to be literate, numerate and financially capable. They must receive information which is intelligible to them and both sales and advice processes must make this information more, rather than less comprehensible. The Bill needs to do more to ensure that consumers get information in a form which they can reasonably be expected to understand and that firms show an appropriate level of care both during and after the sales process. Many financial purchases—particularly pensions and annuities—are very long-term and difficult or impossible to unwind, and regulation must ensure that suitable standards are maintained throughout the lifetime of the contract.

5. Consumers and the PRA

5.1 Although the PRA focus is on safety and soundness of firms, its decision will have significant impacts on consumers, especially those holding with-profits policies. We are concerned that the Bill as currently drafted does not require the PRA to consider the views of consumers, despite the direct effects PRA decisions will have impact on the investments and pensions held by many consumers.

5.2 The Bill should be amended so that the PRA both considers the impact on consumers directly and through consultation with the Consumer Panel. Giving the Consumer Panel a role which spans both PRA and FCA should prove a valuable addition to coordination between the two bodies.

6. Decisive and Effective Regulation

6.1 We warmly welcome both the more proactive approach that the Financial Services Authority has started to take and the Government's recognition of the importance of this culture. We also welcome the commitment to transparency. However, we are concerned that the Bill needs to go further in order to enshrine this approach and ensure that the FCA has the objectives, powers and incentives to be the proactive regulator envisaged by Government.

6.2 Changes are needed to the Bill to clarify that the FCA can take action on unfair charges, and must address consumer detriment identified in super-complaints.

6.3 The Government review of section 348 to be completed during the passage of the Bill must ensure that this legislation enables the regulator to be transparent by publicising warning notices: consumers should be alerted to the regulator's concerns about a firm's behaviour and be able to either switch or even avoid a product altogether.

February 2012

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6 *Family Resources Survey 2009–10,* DWP (2011), table 4.7, Adults, no bank account including Post Office Card Account.
7 *The Way We Pay: Payment Systems and Financial Inclusion,* Age UK, 2011.
8 *Agenda for Later Life Survey, 2012 and 2011,* ICM Research (unpublished).
9 *Financial Services Bill Explanatory Notes;* HMT, (January 2012); p 25.

Memorandum submitted by the British Bankers' Association (FS 08)

Introduction

The British Bankers' Association (BBA) is supportive of the programme of initiatives to reform the UK banking system and views the reform of the UK system of financial services regulation as a key part of this. We have contributed to the three consultations, to the pre-legislative scrutiny process and to relevant inquiries by the Treasury Committee and see the introduction of the Bill into Parliament and the Government's response to the pre-legislative and select committee reports as an important step in putting in place a regulatory regime suited to the strategic oversight of the financial system and capable of delivering judgement-led regulation.

In keeping with the Joint Committee on the draft Financial Services Bill, we consider that successful regulation depends more on regulatory culture, focus and philosophy than structure. An aspect of the cultural change needed is the shift towards forward looking supervision and as the Joint Committee observed this requires staff with the right experience, approach and attitudes. While a change in culture is not something that legislation can guarantee, it is also clear that the setting of the right statutory objectives, the allocation and alignment of powers and responsibility to those objectives, and the establishment of appropriate systems of governance, accountability and engagement is fundamental to the refocus sought. Judgement must also be grounded in good quality data and empirical evidence.

Our Second Reading brief is publicly available and can be accessed here. This note provides a more detailed commentary based on our assessment of issues at the time of the House of Commons' Committee discussion. In this brief we:

— Ask whether the statutory objective of the Financial Policy Committee (FPC) is appropriately defined and includes the right "have regard" to the Government's broader objectives for economic growth.

— Underline the importance of the FPC's activity dovetailing into European and international arrangements and also the importance of the consultative engagement to be set out in the note being prepared by the Bank of England (Bank) and Financial Service Authority (FSA) and the need for this to span the FPC.

— Express support for the new Oversight Committee providing Parliament can satisfy itself that this augments, and sufficiently strengthens, the Bank's accountability to Parliament.

— Question the circumstances in which it would be appropriate for a Governor of the Bank, after serving an eight year term, to become a Deputy Governor.

— Support for the introduction of a focused conduct of business regulator, including the transfer of consumer credit regulation to the Financial Conduct Authority (FCA), noting the diversity of the types of firm and market activity which it will oversee and the geographical limitation of its authority under home/host arrangements.

— Support for the introduction of judgement led supervision, but express concern over the lack of statutory responsibility for international competitiveness, innovation and growth.

— Question whether the commitment to principles of good governance on the part of the new regulatory authorities should be strengthened.

— Welcome the commitment to a single, independent, compensation scheme, support the budgetary oversight by the National Audit Office (NAO), expressing a preference for this oversight to be drawn into a single, coordinated exercise across all of the financial regulation authorities.

— Are supportive in principle of super-complaint powers, but also see these as provisions which will benefit from close attention during the Parliamentary process, as would the obligation to publish determinations under Schedule II, given a firm's inability to appeal.

— Explain that we do not see the need for a fiduciary duty as proposed in amendments tabled given the general principles of the Bill and the provisions of the Markets in Financial Instruments Directive (MiFID).

— Support the duty on the Governor to notify the Treasury in the event of a potential financial crisis, but see a case for broadening the public finance test while at the same time leaving the decision on which special resolution tool to utilise to the Governor.

— Support the preparation of a Memorandum of Understanding (MoU) on the coordination of functions relevant to UK membership and representation in international organisations.

— Support the introduction of provisions for conducting inquiries and investigations and also the investigation of complaints against regulators.

The BBA is the leading trade association for the UK banking and financial services sector. We represent over 200 banking members, which are headquartered in 50 countries and have operations in 180 countries worldwide. These member banks collectively provide the full range of banking and financial services and make up the world's largest international banking centre. As outlined above, we have engaged fully on the development of the Bill; we are also contributing to the work being undertaken in respect of the Government's initiative in response to the Independent Commission on Banking and the many other regulatory reforms being progressed on an international, European and domestic basis.

PART 1: BANK OF ENGLAND (AND THE FINANCIAL POLICY COMMITTEE)

The Financial Services Bill brings together responsibility for all aspects of financial stability within the Bank of England group since:

— the new FPC will be responsible for macro-prudential oversight of the financial services system as a whole;

— the Prudential Regulation Authority (PRA) will be responsible for ensuring the safety and soundness of individual firms; and

— the Bank itself will be responsible for the regulation of systemic infrastructure.

This brings responsibility for financial stability under one roof and subject to specific concerns we are supportive of the broad direction of change.

Clause 3: Financial stability strategy and the Financial Policy Committee

Objectives, modus operandi *and tools*

The establishment of the FPC is a major new addition to the UK regulatory makeup and this makes it all the more important that we lay the right ground rules for its operation. This includes the setting of the right statutory objective, remit and powers and also the shaping of the right governance, accountability and due process mechanisms. The Bill introduced has been amended to clarify the types of risk upon which the FPC should focus, with reference to the interconnected nature of the financial sector and the immateriality of whether the risks involved arise in the UK or elsewhere. It is important to stress that the FPC will be most effective if it acts within the context of the new UK and EU supervisory architecture and does not simply replicate the microprudential supervision of individual firms.

We were pleased to see the Chancellor say to the Joint Committee that we should not be seeking "the stability of the graveyard" and for this to be reiterated during the Second Reading debate where he confirmed that the job of the FPC will be to act "not just to moderate a credit boom but to try and alleviate a credit bust". We agree with this but remain unsure whether this strategic positioning for the FPC is reflected in the statutory objectives for the FPC, or for the Bank's overarching financial stability objective, as set out in the draft Bill.

In particular, we see a case for Parliament reappraising whether the FPC's responsibility for engendering financial stability has been properly set into the context of the Government's wider objectives for economic growth. We would therefore say that in the same way as the 1998 Act sets the objective for monetary policy as maintaining price stability and, subject to this, to support the economic policy of the Government, including its objectives for growth and employment, we believe that the legislation underpinning the FPC be drafted in the same way, specifying that the Bank's "financial (stability) policy" objectives as being:

(a) to maintain a stable and sustainable supply of credit to the economy; and

(b) subject to that, to support the economic policy of Her Majesty's Government, including its objectives for growth and employment.

The proposed objectives for the FPC as set out in Clause 9C(1) of the draft Bill—for the FPC to exercise its functions with a view to contributing to the achievement by the Bank of the Financial Stability Objective as further defined by 9C(2) and (3)—could then be set as "specifications of matters relevant to objectives".

There are two aspects to these proposed changes: first, the focus on a "sustainable supply of credit" would provide a more easily defined objective for the Bank and FPC to work to, and be held account for to Government and Parliament. Secondly, and most importantly, by using the same wording as the monetary policy objective, the FPC's actions would be appropriately set in the wider economic context with due regard for growth, just as when the MPC makes interest rate decisions.

We would view this as a much more positive setting for the work of the Financial Stability Committee—the primary objective of which is clear—and preferable to the *caveat* provided by 9C(4) which adds that the FPC is not required or authorised "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 to long term".

We observe that much of the discussion of the role and purpose of the FPC has focused quite narrowly on strengthening the resilience of the banking sector to withstand financial shocks as opposed to the financial system as a whole—including the shadow banking sector—or attempting to influence more actively the amplitude of the economic cycle. Whilst we recognise the early stage in thinking on these issues, we warn that macroprudential policy should not simply duplicate microprudential supervision of the already heavily regulated banking sector or be used to impose undifferentiated capital surcharges on regulated financial institutions in an effort to mitigate all possible risks to financial stability. Capital buffers of this type are a blunt tool with a questionable track record of effectiveness and the potential to create unintended consequences. To be successful, macroprudential supervision must be broader and consider the wider financial system and drivers of financial instability. In this context, the FPC must consider the tools it will use to mitigate risks in the unregulated shadow banking sector, where risk might migrate with the increase in regulation of the banking sector. This type of analysis should be part of a comprehensive cost-benefit analysis which should be undertaken before either the power of recommendation or direction is used.

We should add that we have responded comprehensively to Bank of England discussion paper on the instruments of macroprudential policy. Our consultation response can be accessed here. In this we explain that while the FPC's directional powers will be an important element of the framework, we would not wish them to overshadow the power to make recommendations, nor the other important drivers of financial stability such as fiscal and monetary policy. In many ways we see the monitoring of financial stability and the provision of early warnings about emerging risks—via FPC minutes and the Financial Stability Review—as the principal responsibilities of the FPC.

This point is reinforced by the fact that the extent to which the proposed directional tools will bind and influence the market remains unclear. Not least due to leakage: the risk that a measure taken by the FPC will be reduced in its effectiveness by, for example:

- lending via foreign branches which will not typically be subject to FPC decisions;
- direct cross-border activity from banks not subject to UK prudential requirements;
- activity by non-bank financial companies and broader financing in capital markets; and
- intra-group corporate lending.

Given that the drivers of financial instability can operate on a global level, it is vital that the issue of leakage is fully considered and mitigated, where possible, by the UK acting in coordination with international partners. Doing otherwise runs the risk that the use of macroprudential tools may evolve into an exercise in distorting UK markets to counteract distortions elsewhere in the world, with the risk of addressing symptoms rather than causes and that effectiveness will be diminished if the UK acts alone.

This discussion cannot be separated from the realities of European Union law and particularly the way in which key pieces of forthcoming legislation, such as the Capital Requirements Directive (CRD) and Regulations (CRR) are implemented. The Bank's stance on "maximum harmonisation" is well known as is its view of the constraints this will impose on the FPC's ability to flex instruments governed by Binding Technical Standards. We believe that it is in the interests of the UK to act in partnership with other Member States through the European Banking Authority and the European Systemic Risk Board to make the case for flexibility in specific areas of the rule book—as is envisaged by the CRR in relation to the risk-weightings attached to residential mortgage lending. This both provides macroprudential flexibility and ensures that concerns over leakage are minimised, at least within the EU. Whilst the paper states that "the rationale for maximum standards is not clear from a prudential perspective" we would simply observe that there is a risk that if one Member State was to impose higher Pillar 1 standards on the banks it supervises then it is possible that this could cause those institutions to retrench their activities in other Member States with destabilising results. The current version of the CRD IV text envisages that the flexibility of Pillar 2 will be enhanced to enable greater macroprudential flexibility.

We also underline the importance of the FPC being subject to the usual due process requirements in respect of the broader instruments that it intends to utilise in fulfilling its role. This includes the dialogue which it has commenced on disclosures within the financial statements of the major UK banking groups. At the time of writing, we are still awaiting the Bank/PRA note on the PRA's proposed consultation arrangements (source: HMT policy document "securing stability, protecting consumers" paragraph 3.30). As the PRA will be charged with acting upon the FPC's recommendations it is important that the note sets out how the consultative arrangements will work in this respect. A clear understanding of the consultative arrangements to be followed is needed to ensure that markets do not misinterpret statements made by the FPC and others.

Clause 4: Further amendments relating to the Bank of England

In the last 12 months a number of public consultations and parliamentary committees—such as the Treasury Select Committee and the Joint Committee—have examined the governance arrangements regarding the Bank of England and produced a number of recommendations. We are therefore disappointed to note that these recommendations have not been fully taken forward in the Bill.

The Government's Response to the Joint Committee states that it will consider the Bank's own proposals in this area "before deciding whether to bring forward further legislative changes". We have noted the response from the Court of the Bank and welcome the recognition that new responsibilities for the Bank in the area of financial stability will need to be accompanied by new accountability mechanisms. We therefore support the creation of an Oversight Committee for financial stability made up entirely of non-executive members of the Court. We further support the intention that the Oversight Committee be expected to commission retrospective reviews of policy-making and implementation performance and agree that the capacity for these should include both internal review and periodic or ad-hoc external review from expert authorities such as the International Monetary Fund (IMF). Parliament will wish to consider how these arrangements fit within the accountability of the Bank to Parliament through the Select Treasury Committee.

We agree that the independence of the Governor of the Bank is vital and for this reason support the move to a single eight-year term as recommended by the Treasury Committee.

We were surprised, however, to see the provision at paragraph 1(6) of Schedule 2 proposing that paragraph 6 be substituted with:

> "6 (1) The fact that a person has held office as Governor of the Bank does not disqualify that person from appointment as Deputy Governor or director of the Bank."

It is not immediately obvious to us the reasons why a Governor should become a Deputy Governor after serving an eight year term as Governor or the circumstances in which this would be appropriate. It would be helpful therefore if this could be explored further in committee.

Part 2: Amendments of FSMA 2000

Clause 5: The new Regulators

Financial Conduct Authority

We support the establishment of a dedicated conduct of business regulator and also the proposed change to the FCA's strategic objective in respect of the functioning of relevant markets and the change to the operational objective in respect of promoting effective competition in the interests of consumers, subject to there being clarity about the role of the FCA and the role of the competition authorities. But we also continue to believe that the FCA should have an operational objective aimed at promoting growth and innovation, given its benefits to both customers and the wider economy. We feel that relegating this objective to solely a competition consideration understates its broader significance. And in the context of competition, we feel that a clear delineation of the responsibilities of the competition authorities and the FCA in statute would remove any uncertainty in this area. This should be complemented by a clear standard for using competition powers, including a transparent appeals process led by an expert, independent body.

We support the transfer of consumer credit regulation to the FCA and the retention of substantive Consumer Credit Act 1974 (CCA) provisions. The Bill maintains the new powers proposed in respect of product intervention, the disclosure of warning notices and the use of misleading financial promotions, each of which raises important issues of principle and a need for appropriate safeguards in respect of the exercise of such strong powers.

We note the definition of "consumer" remains broad and the Joint Bill Committee's support for not restricting this to a narrower category as the draft Bill requires the FCA to tailor its approach to different types of consumer. The FCA is required to have regard to the differing degrees of risk involved in different kinds of investment or transaction; and the differing degrees of experience and expertise that consumers have. However, the FSA's rule book contains a variety of consumer definitions which could usefully be harmonised in the legislation.

The consumer protection objective requires that the FCA has regard to "the different degrees of experience and expertise that different consumers may have". We consider that this could be more explicitly drawn to distinguish different classes of customers, whether wealthy or potentially vulnerable. By extension, this might lead to different requirements and levels of protections, for instance, through the development of simple transparent products.

These and other issues will be explored further not only as part of the Parliamentary process but during the course of planned consultations. In taking thinking forward, it is essential that we have in the forefront of our minds not only the breadth of the FCA's scope, and the diversity of the types of firm and market activity which it will oversee, but also the geographical limitation of its authority under home/host arrangements.

Prudential Regulation Authority

The BBA supports the measures included in the Bill to bring about a more judgement-led approach to regulation and welcomes changes to the Bill intended to strengthen this, some of which were at the suggestion of the Joint Committee. The changes to the Bill are as fundamental as proposing that a duty to supervise be placed on the PRA, which we see as being very distinct in focus from assessing compliance. This is a prime example of the way in which statutory objectives and responsibilities can lay the groundwork for setting the right culture and strategic approach. We note the intention to consult on a draft Order seeking to clarify threshold conditions and effect a division between the PRA and FCA and would underline the importance of getting this right. We also note and support the intention to strengthen the supervisor's powers to monitor emerging risks at the holding company level, subject to caveats about scope and relevant experience in the case of global institutions. We support the shift towards forward looking judgement-led supervision but would make the point that these judgements should be based on timely and accurate data—*ie* grounded in empirical evidence.

We remain disappointed however that the Government has not accepted the case for the PRA and FCA also being required to bear in mind international competitiveness, innovation and growth. We would like to see this reconsidered. We cannot see why the Government would not wish to send out a strong signal that "Britain is open for business" by committing to a competitive regulatory regime. The attractiveness of the UK as a place from which to conduct financial services cannot be taken for granted and there is increasing anecdotal evidence of new operations being established overseas in preference to in the UK. We therefore see a case for a renewed commitment to better regulation and the avoidance of gold plating. We also disagree with the assessment that innovation should not be a relevant factor for the PRA and FCA. We would see this as being entirely consistent with the objectives set for the three European Supervisory Authorities under recital 9aa of the Regulations applicable which require that in each case the authority should take due account of the impact of their activities on competition and innovation, global competitiveness, financial inclusion and the strategy for jobs and growth.

Engagement with practitioners and other interested parties, and the transparency with which this takes place, is an important feature of the UK regulatory landscape. We will therefore take particular interest in the Bank of England and FSA note requested by the Treasury and support the amendment to the Bill to require the PRA to report annually on its consultation activities as part of its annual report.

Further provisions relating to FCA and PRA: Duty to follow principles of good governance

We would question whether the proposition under Chapter 3C on amended FSMA 2000 that in managing their affairs each regulator "must have regard to such generally accepted principles of good corporate governance as it is reasonable to regard as applicable to it" is as positive a statement as Parliament may reasonably have expected.

We further add that we regard transparency and accountability to Parliament as an important check and balance and concur specifically with the Treasury Select Committee's recommendations in this regard including the expectation that the Chief Executive of the FCA be subject to pre-appointment scrutiny by the committee. We would also envisage the committee wishing to hold the Chief Executive of the FCA (and the PRA) to the same level of accountability as applies currently to the Chief Executive of the FSA.

Clause 35: The Financial Services Compensation Scheme

We welcome the Government's commitment to a single, independent, compensation scheme.

We welcome the intention that the FSCS and FOS be placed under a statutory obligation to publish annual plans and be audited by the NAO the Government's proposals in relation to the FSCS which implement dual lines of accountability to both the PRA and FCA with supporting oversight from the NAO. Our preference, however, would be for this budgetary responsibility to be fully coordinated and drawn into a single budgetary exercise spanning all of the financial regulatory authorities.

The role of the FSCS has expanded in recent years to include financing the ex ante costs of resolution. In addition to this, the recast Deposit Guarantee Schemes Directive is expected to introduce mandatory pre-funding requirements for the FSCS deposit sub-scheme. While we support the FSCS assuming responsibility for overseeing and managing the Deposit Scheme pre-fund, we also see a case for reviewing its governance arrangements in order to ensure that the FSCS Board has the experience and technical expertise needed to oversee the Scheme's new responsibilities.

New Clause 217A provides for FCA, PRA and the FSCS to co-operate with each other in relation to the FSCS. There should be an explicit obligation under these co-ordination arrangements for an ongoing review of the fitness for purpose of the Scheme's funding arrangements.

Clause 40: Provisions about consumer protection and competition

We note the Bill provides that consumer representatives should be able to make super-complaints to the FCA and also the Government's intention that, in a narrow range of circumstances, firms and the FOS should be able to refer matters concerning mass detriment to the FCA and require a response in 90 days. This extends the scope of those potentially raising provisions far wider than under the existing provisions of the Enterprise Act (2002). Whilst we are supportive in principle of super-complaint powers, these are also provisions which will benefit from close attention during the Parliamentary process (not least as they have been introduced without full prior consultation), as would the obligation to publish determinations under Schedule II, given a firm's inability to appeal. In order to avoid conflicts of interest it may be sensible for the legislation to exclude organisations which provide, promote or intermediate advice on financial services themselves from becoming a "nominated party".

We note that amendments to the Financial Services Bill have been put forward with a view to introducing a new fiduciary duty into English law (see, for example, Amendments 49 and 64). Our assessment is that a statutory fiduciary duty to create a level playing field between firms' and consumers' responsibilities is neither necessary nor helpful to consumers since the Bill already contains a general principle that "those providing financial services should be expected to provide customers with a level of care that is appropriate having regard to the degree of risk involved…and the capabilities of the consumers in question", which is a principle that we support. MiFID, which applies to various activities related to investment business (*eg* advising on and dealing in investments), also includes duties similar to fiduciary duties as it requires firms to act in the best interests of clients, disclose third party inducements and manage out or disclose conflicts of interest.

Part 3: Mutual Societies

No comment at this stage.

Part 4: Collaboration between Treasury and the Bank of England, FCA or PRA

Clause 54: Duty of the Bank to notify Treasury and Bank of England, FCA or PRA

We have previously expressed concern, in the context of crisis management, over the lack of clarity about the duty on the part of the Governor to notify the Chancellor of a potential financial crisis and view the arrangements set out in the Bill and the MoU as being more in keeping with the type of interaction that we believe is likely to take place. The provisions, however, merit further consideration since we are unclear that the assignment of powers now proposed is consistent with the strategic division of responsibilities envisaged by the Government, including the proposed power of direction over the Bank; we expand upon this below in respect of Clause 61.

Clause 60: Duty of the Treasury, Bank and PRA to co-ordinate discharge of functions

While we are fully appreciative of the distinct roles to be played by the PRA and FCA, it is equally clear that there is a clear need for effective coordination between the two if duplication and administrative burden and confusion in firms' daily regulatory engagement are to be avoided. We are therefore pleased to see the mechanism for coordination being put in place and the accountability that will underpin these and will consider in particular the MoU provisions relating to the FSCS, the way in which the FCA and the FOS will work together and the relationship between the FCA and the Money Advice Service (MAS). An initial inspection suggests that concerns relating to the governance of these bodies may not have been fully met.

We concur with the view that there are detailed and complex considerations in respect of issues such as the disclosure of information and the legal liability in the case of failed banks and look forward to the analysis and consultation expected to take place during the passage of the Bill.

Clause 61: Memorandum of understanding: crisis management

We are supportive in principle of the notification arrangements set out in the MoU but have identified the following issues which require further detailed consideration:

- whether the public funds test will in future be the right basis upon which to determine that the Chancellor should be notified of the threat to financial stability;
- whether the responsibility on the part of the Bank to notify the Chancellor may have a behavioural effect on the PRA's assessment of the threshold conditions for resolution; and
- whether placing the decision on whether to utilise any bail-in capacity into the hands of the Chancellor (charged with the protection of public funds) and out of the Bank's (charged with protecting financial stability) may contribute to the financial deterioration of the institution concerned.

Clause 62: Memorandum of understanding: international organisations

The BBA was one of the organisations that in recognition of the importance of UK engagement in global and European regulatory bodies recommended the establishment of an international regulatory secretariat. We are therefore pleased to see the amendment to the Bill to require that the international coordination MoU establish a committee under Treasury chairmanship and reporting to the Chancellor, with FCA, PRA and Bank membership, with the aim of agreeing consistent objectives and effective international engagement. As the Treasury policy document illustrates, this engagement takes very different forms across the different authorities spanning the PRA's participation in supervisory colleges and the European Banking Authority engagement on the part of both the PRA and the FCA in international regulatory discussions.

So, for instance, we can see the logic of the division of responsibility between the Bank and FCA in respect of market infrastructure, but also see the importance of the Bank and FCA working closely on regulatory matters, including those where the Bank is the competent authority but the FCA holds the UK voting seat in the European Securities and Markets Authority (ESMA).

Part 5: Inquiries and Investigations

We support the introduction of provisions on the conduct of inquiries and investigations.

Part 6: Investigation of Complaints against Regulators

We support the introduction of arrangements for the FCA, PRA and the Bank to put in place a scheme for the prompt, independent investigation of complaints made against them in respect of their relevant functions.

Part 7: Amendments of Banking Act 2009

Part 8: Miscellaneous

Part 9: General

No comment at this stage.

February 2012

Memorandum submitted by the Association for Financial Markets in Europe (AFME) (FS 09)

1. Introduction

1.1 The Association for Financial Markets in Europe (AFME) welcomes the opportunity to give evidence to the Financial Services Bill Committee (the Bill Committee) on the Financial Services Bill (the Bill).

1.2 AFME represents a broad array of European and global participants in the wholesale financial markets: our members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. In giving evidence to the Bill Committee, AFME will, therefore, focus on wholesale financial services issues as well as dealing with more general issues of concern to our members, the majority of which will be regulated by both the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) (*ie* "dual regulated firms").

2. Key Points

2.1 The Bill is a highly detailed legislative proposal that seeks to create a new, and more appropriately robust, framework for financial regulation by building upon extant financial services legislation, principally the Financial Services and Markets Act 2000 (FSMA). AFME has played an active role in responding to the consultation documents and calls for evidence relating to the development of the new framework and supports, in principle, the main changes the Bill will introduce: in particular:

— the creation of a body—the Financial Policy Committee (FPC)—with responsibility for macro-prudential oversight;

— the separation of prudential regulation from conduct regulation; and

— although judgment-led regulation is predicated on the new regulators having appropriately skilled and experienced supervisors and high quality data, the move away from a, so called, "box-ticking" regulatory culture to a style of supervision that is appropriately interactive and judgmental (provided judgments are, where possible, based on empirical and unequivocal data).

2.2 As noted in our submission to the Joint Committee, the Bill endeavours to strike the right balances between, amongst other things:

— empowering regulators and at the same time providing appropriate checks and balances (including rights of appeal for regulated firms and accountability to Parliament); and

— enshrining sufficient detail with respect to the operation of the new framework whilst giving the new regulators freedom to determine the specific operational arrangements.

However, as discussed below, in a number of areas we believe that the appropriate balances have not yet been achieved.

2.3 In particular, we believe that:

— a high-level mechanism to facilitate domestic coordination—particularly once the PRA and the FCA develop as separate regulators, with distinct and different regulatory cultures—and provide for dispute resolution, should be enshrined in the Bill; and

— whilst the need for new and enhanced regulatory powers is recognised, the Bill should prescribe, to a greater degree of granularity, the powers to be given to the new regulators, including, where appropriate, tests/thresholds for their usage; due process to ensure procedural fairness; and accountability to Parliament.

2.4 We also believe that the Bill should recognise explicitly where the extent and use of powers is modified or limited by EU regulation and articulate how the domestic and EU regulatory regimes interrelate (*eg* in relation to product intervention rules).

3. Detailed Comments on Amendments to FSMA

We set out our detailed comments below. Given the shortage of time available to consider the Bill and the need to provide written evidence at an early stage, we have focused on amendments to FSMA. Given the complexity and volume of amendments likely to be debated by the Bill Committee, we believe that a number of the key substantive issues will need to be revisited, in more detail, in the House of Lords Committee stage—we hope this will be confirmed in the Bill Committee's discussions.

3.1 Clause 5, new section 1C: *The consumer protection objective*

3.1.1 We support the inclusion, in subsection (2), of a general principle that "those providing financial services should be expected to provide customers with a level of care that is appropriate having regard to the degree of risk involved . . . and the capabilities of the consumers in question."

3.1.2 Common Law also imposes a fiduciary duty on firms in appropriate cases eg where an advisor receives payment from a retail client for the provision of advice upon which the client relies. Importantly, whether or not a fiduciary relationship is imposed is judged on the facts (*eg* in the case of *JP Morgan Chase* v *Springwell*,[10] the Court held that a bank's non-advisory relationship with a "sophisticated investor" did not give rise to a fiduciary duty). Hence, we do not believe that a statutory fiduciary duty is necessary or, in certain relationships, appropriate.

3.1.3 It is also important that the "have regard to" factors require the FCA to differentiate appropriately between different types of consumers—focusing, in particular, on the protection of retail consumers—when developing policy, particularly with respect to the use of its powers.

3.2 Clause 5, new section 2K: *The PRA's general duty to consult*

3.2.1 The Bill enables the PRA to determine its own arrangements for consultation with stakeholders which "may" include the establishment of Panels.

3.2.2 Whilst we recognise that the Bank has a long track record of consultation with stakeholders, we believe the Bill should extend the remit of the FCA's Practitioner Panel to both the FCA and PRA, thus enabling the Panel to provide input on matters relating to coordination and continue to provide input on the prudential-regulation of dual-regulated firms (rather than just the prudential regulation of FCA-authorised firms).

3.3 Clause 5 and Schedule 3, new Schedule 1ZA, paragraph 10 and new Schedule 1ZB, paragraph 18: *Annual report*

3.3.1 We believe that, to enhance accountability, the regulators' annual reports should include pertinent information on the use of new regulatory powers (including statistics on usage and results, such as the number of Warning Notices published, withdrawn, and upheld) and that measures of regulatory success should also be evidenced through non-enforcement statistics. We believe that such additional information would assist Parliament in judging the effectiveness of the new regulators.

3.4 Clause 5, new section 3E: *Memorandum of understanding*

3.4.1 The (draft) Memorandum of Understanding (MoU) between the PRA and the FCA is framed at a fairly high-level of generality. Whilst the MoU is clearly important, effective coordination will be predicated on the regulators having clearly defined responsibilities and appropriately designed operating procedures and staff, at all levels, developing and maintaining good working relationships. Once the PRA and the FCA have developed distinct corporate cultures, a collaborative, non-adversarial environment that enables and encourages staffers to continue to work together—long after corporate memories of the Financial Services Authority (FSA) have faded—will be vital.

3.4.2 Given the above, dual-regulated firms are still concerned as to whether, and, if so, how, coordination will work in practice. Hence, we strongly believe that the Bill should establish a mechanism through which day-to-day domestic operational coordination can be facilitated; as discussed in detail in our responses to HM Treasury, we consider that a domestic coordination committee should be enshrined within legislation.

3.4.3 The Treasury's power, in new section 3G FSMA, to establish a boundary between FCA and PRA responsibilities is helpful, but we are concerned that it may not be appropriate to resolve disputes that arise where the boundary is difficult to determine (*eg* systems and controls rules) or relate to operations. Although the Treasury can require the regulators to consult each other, given that an agreement might not be reached, we believe that the Bill and/or the MoU should provide for formal dispute resolution arrangements.

3.5 Clause 14: *FCA to exercise functions under Part 6 of FSMA 2000*

3.5.1 We do not believe that the FCA's operational objectives are sufficiently tailored for a listing authority. Hence, when the FCA is operating as the UKLA, it should continue to be subject to the general duty and "have regard to" factors set out in section 73 of FSMA. Although it is proposed that this section be deleted by clause 14(13), we believe that it remains appropriate for the specialised regulatory functions performed by the UKLA.

3.6 Clause 16: *Listing rules: disciplinary powers in relation to sponsors*

3.6.1 Under new section 88E, the FCA may take action against a sponsor "if it considers that it is desirable to do so in order to advance one or more of its operational objectives".

[10] *JP Morgan Chase Group* v *Springwell Navigation Corporation* [2008] EWHC 1186.

3.6.2 We believe that the FCA should be required to have reasonable grounds for using this power against sponsors—such as breaches of regulatory requirements—and should otherwise use general rule making powers to advance its objectives.

3.7 Clause 21: *Proceedings before Tribunal*

3.7.1 New section 133(6) limits the Tribunal's powers in respect of a non-disciplinary reference, providing that the Tribunal must remit such a case back to the regulator rather than determine the action to be taken. We have reservations regarding the two-tier review process that the Bill thereby creates—at a minimum we believe the Tribunal should remit cases back with recommendations—and we are concerned too that the list of disciplinary references in new section 133(7A) is not complete.

3.7.2 In particular, we note that references relating to a prohibition order against an approved person under section 56 of FSMA (notwithstanding that it suspends or ends an individual's career in financial services) or an own-initiative variation or cancellation of a firm's permission under section 45 of FSMA, are not categorised as disciplinary. In our view, such cases require high standards of procedural fairness: hence the Tribunal's powers to determine the action to be taken should not be fettered.

3.8 Clause 22, new sections 137C: *FCA general rules: product intervention*

3.8.1 We believe the Bill should set a higher threshold for use of the FCA's power to make product intervention rules, in order to ensure that the power is not used routinely—for reasons of expediency—but only in exceptional circumstances where there is a likelihood of significant consumer detriment.

3.8.2 In particular, the "necessary or expedient" test in new section 137C(1) of FSMA is too wide and should be redrafted to ensure consistency with (draft) article 32 of Markets in Financial Instruments Regulation (MiFIR), Product intervention by competent authorities, which will, when made, have binding effect in the UK. For example, under (draft) article 32(2) of MiFIR, a competent authority would only be permitted to make product intervention rules when, amongst other things, there is a serious threat to the orderly functioning and integrity of financial markets or stability and existing regulatory requirements do not sufficiently address the risks.

3.8.3 New sections 137C(2) and 137(3), will enable the FCA to prohibit agreements to be specified in its rules. We believe that the Bill should require there to be a *nexus* between a "specified agreement" and the carrying on of a regulated activity.

3.8.4 New section 137C(3) permits the FCA to make "general rules" describing a type of product that is prohibited and new section 137(C)(7) permits the FCA to provide that an agreement is unenforceable and/or require firms to unwind prohibited agreements and pay compensation. A key issue is the extent to which these powers enable the FCA to apply hindsight and ban products and agreements retrospectively. Hence, to provide certainty for parties contracting in good faith, we believe that a limitation, similar to section 139A(11) of the Financial Services Act 2010, should be included in the Bill.[11]

3.9 Clause 22, new sections 138M: *Consultation: exemptions for temporary product intervention rules*

3.9.1 New section 138M provides an exemption from the consultation requirements for temporary product intervention rules if the FCA "considers that it is necessary or expedient…for the purpose of advancing" the consumer protection or competition objective.[12] Again, we believe that this provision should be consistent with MiFIR *ie* reserved for emergency situations.

3.10 Clause 22, new section 137Q: *Financial promotion rules: directions given by FCA*

3.10.1 We believe that publication of directions given by the FCA should be subject to a public interest test and, similar to the Advertising Standards Authority, the FCA should be required to publish a summary of representations made. In the interests of procedural fairness, we do not believe that directions which are revoked by the FCA should be published under section 137Q(11).

3.11 Clause 34 and Schedule 9: *Discipline and enforcement, paragraph 20(4)(b)—amended section 387(2)—and paragraph 26(3)(a))—amended section 393(3)*

3.11.1 We are concerned that the standard period to make representations has been reduced from 28 days to 14 days—particularly since we understand that lawyers acting on behalf of firms frequently need to request extensions beyond the current 28 days—and believe that this amendment could be perceived as putting pressure on defendants, possibly with a view to encouraging early settlement. Whilst we recognise the argument that

[11] The Joint Committee on Human Rights considered the *ex post facto* effect of section 139A (General rules about remuneration) powers in the previous Financial Services Bill. In their report of 21 December 2009, the Committee noted that it: "appears that the general worded power in the Bill, which, on its face, appears to give the FSA the power to interfere with existing contractual terms, is not intended to do so. We recommend that the Government make this limitation explicit on the face of the Bill, which should meet the concerns about the provision's compatibility with Article 1 Protocol 1." This limitation now appears as section 139A(11) of the Financial Services Act 2010.

[12] or, by order of the Treasury, the integrity objective.

there is a need to speed up enforcement cases, given the time taken in respect of other parts of the process, it is unfair to limit a firm's or individual's opportunity to review the case against them, as set out in the Warning Notice, and make written representations.

3.12 Clause 34 and Schedule 9: *Discipline and enforcement, paragraph 24(2), amended section 391*

3.12.1 We recognise that transparency with respect to the commencement of enforcement proceedings may, in egregious cases with probable consumer detriment, enhance consumer protection. However, given the differences between the exercise by a regulator of an administrative jurisdiction and criminal law, as discussed in our submission to the Joint Committee, we believe that the Bill should include additional checks and balances, over and above the important Maxwellisation obligation to consult those named, if ongoing enforcement action is to be made public before the formal representations stage.

3.12.2 The procedures for the issue of a Warning Notice[13] require a far lower standard of proof than the evidential test in the Code for Crown Prosecutors (the Code). A charge is also subject to review/approval by the Crown Prosecution Service (CPS), whereas a Warning Notice, despite being reviewed by the FSA's Regulatory Decisions Committee, is more akin, in procedural terms, to a caution, as it is issued at the sole discretion of the FSA without a wholly independent review.

3.12.3 In addition, the Bill, unlike the Code, does not require the FCA to satisfy a "public interest" test, to distinguish between cases where urgent publication is necessary in the interests of consumer protection (*eg* cases involving systemic miss-selling) and other enforcement cases.

3.12.4 Hence, we believe the Bill should require that the FCA to satisfy both a higher standard of proof and a public interest test before publishing a Warning Notice. The FCA should also be required to publish a Code of Practice and, if a case is closed or not proven, issue an equally prominent statement.

3.13 Clause 34 and Schedule 9: *Discipline and enforcement, paragraph 28(3)(b)*

3.13.1 Under amended section 395, the decision-makers for Supervisory Notices may now include a person who is directly involved in establishing the evidence upon which the decision to issue a Supervisory Notice is based.

3.13.2 Given that Supervisory Notices are likely to become increasingly important in judgment-led regulation, we are concerned that the involvement of "conflicted" FCA/PRA executives in the decision to issue a Supervisory Notice could give rise to a perception of bias, which could result in more cases being referred to the Tribunal.

3.14 Clause 38 and Schedule 12: *Information, investigations, disclosure etc., paragraph 5, amended section 166, Reports by skilled persons*

3.14.1 As discussed in our response to the Joint Committee, over the last five years there has been a significant increase in both the FSA's use, and the costs of, section 166 reports.[14] Given the significance of the costs involved, it is important to ensure that the s.166 power is used proportionately.

3.14.2 Under new section 166A, regulators will have the power to appoint a skilled person to bring a firm's records up to date. It is important that this power is not used routinely and that consideration is given first to the desirability of the firm updating its own records under appropriate scrutiny.

3.14.3 Under amended section 166(3)(b), the PRA and the FCA will themselves now have the power themselves to appoint a skilled person to provide them with a report on a firm. A skilled person directly appointed by a regulator will not, however, have any contractual obligations to the firm upon which they are reporting. We are concerned that, as a result, firms will have no safeguards with respect to the quality of skilled persons' work (regulators having statutory immunity).

3.14.4 Hence, we are of the view that the regulators powers to appoint skilled persons directly should be subject to appropriate limitations—*eg*, to circumstances in which there is legitimate public interest in the outcome of the report or where regulators have significant concerns re the fitness and propriety of a firm.

3.15 Clause 54: *Duty of Bank to notify Treasury of possible need for public funds*

3.15.1 We believe that, given the potential risks to clients, the Treasury should also be notified when the PRA triggers the Special Resolution Regime or a firm enters the Special Administration Regime.[15]

[13] Set out currently in FSA's Decision Procedure and Penalties manual (DEPP).

[14] The FSA, in DP10/3 (March 2011), "estimates that 140 (reports) will be initiated in 2010–11 compared with 88 in 2009–10 and only 18 in 2006–07." A Freedom of Information disclosure by the FSA gives the average cost to firms of a section 166 report as £128,000 in 2009–10 (£80,000 in 2007–08) with the most expensive in that year being £4.4 million (£1.1 million in 2007–08).

[15] It is our expectation that the FCA, as the client assets regulator, will have a defined—but not necessarily exclusive—role in relation to the Special Administration Regime.

3.16 Clauses 61: *Memorandum of understanding: crisis management*

3.16.1 We are concerned that there is no formal role for the FCA in the crisis management MoU, despite its responsibilities for the regulation of client assets.

3.16.2 We believe that the FCA's role should be enshrined in the Bill and that the MoU should detail how the regulators will coordinate in relation to client asset protection.

3.17 Clause 62: Memorandum of understanding: *international organisations*

3.17.1 We strongly support the new high-level international coordination committee provided for in clause 62(5)(b): we believe that this committee will be essential for maintaining the UK's effectiveness, particularly as regards coordination with the European Supervisory Authorities.

3.18 Clauses 79 to 83: *Arrangements for the investigation of complaints*

3.18.1 We strongly support the single complaints scheme provided for in the Bill, which should ensure that complaints relating to regulatory coordination are dealt with consistently.

February 2012

Memorandum submitted by Bates Wells & Braithwaite London LLP (FS 10)

AMENDMENTS 72 AND 73—SOCIAL INVESTMENT

1. Summary

1.1 As the Financial Services Bill is at the Committee Stage, we are writing to you as members of the Committee to ask you to accept amendments 72 and 73 to the Bill. The amendments are set out below at paragraphs 4 and 5.

1.2 The amendments would:

1.2.1 place a general "social investment duty" on the FCA to carry out its work in a way which promotes the development of social finance and social investment; and

1.2.2 require the FCA to establish a "social investment panel" of persons with knowledge and expertise in social finance and social investment which it would be obliged to consult and have regard to over time in relation to the conduct of its activities.

1.3 The amendments pave the way for the growth of the social investment market, which is about to receive a large injection of capital from Big Society Capital, a new social investment wholesaler set up under the Dormant Bank and Building Society Accounts Act 2008, and which is currently experiencing a wave of innovation and requires sensitive regulation.

2. The Amendments

2.1 The amendments:

2.1.1 recognise the growing importance of social finance and social investment, examples of which are listed at paragraph 3 below;

2.1.2 acknowledge that social finance is a developing market requiring proportionate regulation (for further information see "*Investing in Civil Society: A framework for bespoke regulatory regime*", produced by NESTA and BWB);

2.1.3 are consistent with Government's the strategy of growing civil society and the social investment market at a time of fiscal austerity and public spending cuts;

2.1.4 would help Big Society Capital to achieve its aims and be a success. Big Society Capital was set in motion by virtue of the Dormant Bank and Building Society Accounts Act 2008, whilst the Labour party were in Government and has been taken forward by the Coalition Government;

2.1.5 would be an example of support for responsible capitalism and would be a step towards creating a "John Lewis economy" with greater shared wealth;

2.1.6 would make sure that the FCA has social finance and social investment in its "DNA", encouraging responsive and sensitive regulation in a developing area;

2.1.7 would ensure that the FCA does not adopt a regulatory approach which unnecessarily inhibits innovation in social finance and social investment;

2.1.8 would help the UK to strengthen its place as a leading global centre for social finance and social investment; and

2.1.9 would help the UK to remain competitive with other often smaller, more mobile jurisdictions in the growing international impact investment market.

2.2 The amendments are simple, modest and stand-alone, do not cost the taxpayer and do not interfere with any other aspects of the Bill. At a time of austerity and public funding cuts for charities, the amendments would help to support the role of social investment to finance civil society and would help the UK to develop as a leading international destination for social investment.

2.3 Without the amendments, it is likely that the FCA will continue to place a very low priority on social finance and social investment and that financial services regulation will continue to have unintended consequences for the growing social investment market in the UK and will continue to impede the ability of the UK to win its fair share of the growing international social investment market. As currently drafted, the Financial Services Bill places no obligation upon the FCA to pay particular attention to the social investment market, which is innovative, often unorthodox and does not therefore readily fit into the existing financial services regulatory categories, whether that is in respect of the regulation of financial promotions, regulated activities, collective investment schemes or otherwise.

2.4 In summary, the absence of any social investment duty on the FCA or any obligation to consult with the social investment market jeopardises current Government strategy on social investment.

3. Government Policy on Social Investment

3.1 The amendments are consistent with the Government's aim to grow civil society and the social investment market (see the Cabinet Office paper on "*Growing the Social Investment Market: A vision and strategy*").

3.2 The amendments would help Big Society Capital to achieve its aim of developing a new class of social finance intermediaries which will help to finance and capitalise civil society organisations across the UK (see www.bigsocietycapital.com).

3.3 It is hoped that social investment will grow civil society, assist the development of more open public services, advance localism and enable more payment by results and outcomes focussed financing of charities and social enterprises.

4. Innovations and Developments in Social Investment

4.1 The amendments acknowledge the special features of social investment and reflect growing innovation in the social investment market, including:

(a) the establishment of Big Society Capital;

(b) the launch of social venture funds such as Big Issue Invest and Bridges Ventures;

(c) the development of social impact bonds, such as those piloted by Social Finance, including the Peterborough Prison Social Impact Bond;

(d) the issuance of listed charity bonds, such as the bond recently issued by Scope;

(e) the growth of crowd-funding and peer-to-peer lending, such as BuzzBnk and Zopa;

(f) the development of new internationally focussed impact investment funds, such as the recent impact investment fund launched by Oxfam; and

(g) the prospective launch in London in the next year of a "Social Stock Exchange" for social enterprises, which is one of the first investments by Big Society Capital.

5. Amendment 72

5.1 The text in italics below is part of Clause 1B of the original Financial Services Bill as introduced to Parliament on 27 January 2012.

5.2 Amendment 72 would be inserted at the end of Clause 5, page 16, line 7, as shown below.

The FCA's general duties

1B The FCA's general duties

(1) In discharging its general functions the FCA must, so far as is reasonably possible, act in a way which—

(a is compatible with its strategic objective, and

(b) advances one or more of its operational objectives.

(2) The FCA's strategic objective is: ensuring that the relevant markets (see section 1F) function well.

(3) The FCA's operational objectives are—

(a) the consumer protection objective (see section 1C);

(b) the integrity objective (see section 1D);

(c) the competition objective (see section 1E).

(4) The FCA must, so far as is compatible with acting in a way which advances the consumer protection objective or the integrity objective, discharge its general functions in a way which promotes effective competition in the interests of consumers.

Amendment 72

"(5) The FCA must, so far as is compatible with acting in a way which advances its operational objectives, discharge its general functions in a way which promotes the growth and development of social finance and social investment.".

(5) In discharging its general functions the FCA must have regard to—

(a) the regulatory principles in section 3B, and

(b) the importance of taking action intended to minimise the extent to which it is possible for a business carried on—

(i) by an authorised person or a recognised investment exchange, or

(ii) in contravention of the general prohibition, to be used for a purpose connected with financial crime.

(6) For the purposes of this Chapter, the FCA's general functions are—

(a) its function of making rules under this Act (considered as a whole),

(b) its function of preparing and issuing codes under this Act (considered as a whole),

(c) its functions in relation to the giving of general guidance under this Act (considered as a whole), and

(d) its function of determining the general policy and principles by reference to which it performs particular functions under this Act.

(7) Except to the extent that an order under section 47 of the Financial Services Act 2012 (orders relating to mutual societies functions) so provides, the FCA's general functions do not include functions that are transferred functions within the meaning of section 48 of that Act.

(8) "General guidance" has the meaning given in section 139B(5).

6. Amendment 73

6.1 Amendment 73, below, would be inserted at the end of clause 5, page 22, line 44.

6.2 The Social Investment Panel would be established along with the proposed Practitioner Panel, Smaller Business Practitioner Panel, Markets Practitioner Panel and the Consumer Panel.

"1R The Social Investment Panel

(1) Arrangements under section 1M must include the establishment and maintenance of a panel of persons (to be known as "the Social Investment Panel") to represent the interests of organisations which specialise wholly or mainly in social finance or social investment.

(2) The FCA must appoint one of the members of the Social Investment Panel to be its chair.

(3) The Treasury's approval is required for the appointment or dismissal of the chair.

(4) The FCA must appoint to the Social Investment Panel such—

(a) individuals who represent organisations carrying out social finance activity, and

(b) individuals who represent social sector organisations receiving social investment, as it considers appropriate.

(5) The FCA may appoint to the Social Investment Panel such other persons as it considers appropriate.

In making the appointments, the FCA must have regard to the desirability of ensuring the representation of a range of different forms of social sector organisations.".

7. Bates Wells & Braithwaite London LLP

Bates Wells & Braithwaite has long been at the forefront of the development of social investment and is a leading social finance law firm, which advises the majority of the organisations in support of the amendments.

8. Organisations in Support of the Amendments

(a) Charity Finance Directors Group (body for charity finance directors).

(b) Association of Chief Executives of Voluntary Organisations (membership body for the leaders of third sector organisations in England and Wales).

(c) National Council for Voluntary Organisations (umbrella body for the community and voluntary sector in England).

(d) Investing for Good (specialist provider of impact investment services to private banks, asset managers and foundations).

(e) CAN Mezzanine (charity landlord offering office space to other social enterprises and charities).

(f) Bridges Ventures (a firm which invests for financial returns and social impact).

(g) FSE Group (comprises the fund managers FSE Loan Management, FE Loan Management, operating as Finance East, and South East Fund Managers, which invest in small and medium sized businesses, as well as FSE Investor Networks, a group of business angel networks and clubs operating throughout the UK).

(h) Charity Bank (finances social enterprises, charities and community organisations).

(i) Social Enterprise UK (a national organisation promoting social enterprise in the UK).

(j) Community Development Finance Association (the membership body for community development finance institutions in the UK).

(k) Social Finance (which was set up to lay the foundations for a social investment bank).

(l) Social Investment Business (the UK's largest social investor).

(m) Social Stock Exchange (which is preparing for launch in the UK and will allow investors to trade exclusively in companies with social and environmental goals).

(n) Big Issue Invest (a specialised provider of finance to social enterprises and charities).

(o) Big Society Capital (the social investment wholesaler).

(p) Clearly So (connects social business and enterprises with potential investors and corporations looking to engage with the social economy).

(q) UK Sustainable Investment and Finance Association (the member association of the UK social, ethical, and green investment industry and community).

(r) The Young Foundation (brings together insights, innovation and entrepreneurship to meet social needs).

(s) Triodos Investment Banking (one of the world's leading sustainable banks, which strives to make money work for positive social, environmental and cultural change).

We hope that you will support the amendments.

February 2012

Memorandum submitted by HSBC Bank plc (FS 11)

With our headquarters in London, HSBC is one of the largest banking and financial services organisations in the world. Our international network has around 7,500 offices in 87 countries and territories across Europe, the Asia-Pacific region, North, Central and South America, the Middle East and Africa. In the UK, we employ 52,000 people and run a 1,250-strong branch network.

The Financial Services Bill will fundamentally change the way banks and financial services firms are regulated in the UK.

This paper summarises the key issues and amendments that we believe are required to the Bill, in relation to the FPC, PRA and FCA, which we ask you to consider.

Executive Summary

Financial Policy Committee (FPC)

— As currently drafted, the objective of the FPC is too narrowly focused on the avoidance of negative outcomes, without an overriding objective related to supporting the proper functioning of the economy.

— The FPC's objective should parallel that of the MPC, and should focus on "ensuring a stable and sustainable supply of finance to the economy", rather than the amorphous concept of "financial stability".

Prudential Regulatory Authority (PRA)

Upper Tribunal

— The Upper Tribunal must be able to overrule the decision of a regulator (either the FCA or PRA), rather than simply remit it back for reconsideration by the regulator as the Bill currently proposes.

Accountability

- The PRA should be subject to the same statutory accountability requirements as the FCA, with a statutory practitioners' panel which it is required to consult on rule changes as well as an annual public meeting for stakeholders. New section 2K(2) (clause 5) should be amended to provide that "the PRA's consultation requirements must include the establishment and maintenance of a practitioner panel to represent the interests of practitioners".

Financial Conduct Authority (FCA)

Fiduciary Duty

- Firms should not be subject to a fiduciary duty of care to consumers. A fiduciary duty would place the full authority to transact on behalf of customers with banks. This would remove responsibility from customers, create a situation where they no longer have any motivation to behave responsibly, and could make it harder to establish a relationship of mutual trust.
- There are already certain situations in which firms owe a fiduciary duty to consumers, such as trusts, but these situations are very limited. In other circumstances, such as when firms give advice to consumers, there are duties which arise but these are to exercise reasonable skill and care rather than conferring a fiduciary duty.

Competition

- The FCA will become the lead competition regulator in the UK. We believe that it should be subject to similar procedural and appellate safeguards as other competition regulators in the UK.

Product Intervention

- The scope of the product intervention power is broad and the Bill should make clear that the power should only be exercised "where it is appropriate and proportionate, and where it will provide clarity to consumers and firms".
- The safeguards in relation to the FCA's product intervention power need to be strengthened. In particular, firms should have the right to challenge a decision to intervene and a proper appeals mechanism against an FCA decision to use this power, besides judicial review.

Financial Promotions Power

- The FCA should be required to take into account the representations of individuals to whom a notice under this power is given.
- The FCA should not be required to publish details of a proposed notice if it decides to revoke it following representations.

Early publication of disciplinary action

- Firms should have the right to comment on early warning notices and whether their publication is appropriate. In addition, the FCA should be required to state, when it publishes a notice in spite of comments that it is not appropriate to do so, why it is not unfair to proceed with publication.

Panels

- We believe that the existing provision under FSMA (Section 11(3)) which requires the FSA to provide reasons in writing to the panels where it disagrees with a view expressed by a panel should be retained.

Further detail on each of these issues is below.

The Financial Policy Committee (FPC)

1. We support the creation of the FPC as we believe that it is sensible to have an over-arching regulator able to oversee the financial sector as a whole.

(i) *Objectives and Accountability*

2. We believe that the FPC's objectives, as currently drafted, are too focused on the avoidance of negative outcomes by being based around an insufficiently-defined concept of "financial stability". We believe that this could create an in-built bias to risk-aversion into the system, which is likely to be at the expense of the wider economy.

3. Furthermore, we believe that the accountability mechanisms proposed for the FPC are not sufficiently robust.

Key Points

— 4. The FPC's objective should more closely parallel that of the MPC, and should focus on "ensuring a stable and sustainable supply of finance to the economy". Within this, the FPC should be required to support the economic policy of HM Government, including its objectives for growth and employment.

— 5. The FPC's accountability should mirror that of the MPC. The FPC should be required, whenever it undertakes any policy action, to write to the Chancellor and Chair of the TSC to explain the reasons for taking that action. This should include both a cost-benefit analysis and an economic impact assessment of its decisions.

The Prudential Regulation Authority (PRA)

6. We are broadly supportive of the approach and arrangements for the PRA, but there are certain amendments to the Bill that we believe could be made.

(i) *The Upper Tribunal*

7. The Upper Tribunal is the primary mechanism of redress for firms against the decision of the regulator. Currently, the Tribunal has the power to overturn the regulator's decision, and this provides an essential check on its power and gives an appropriate level of protection for firms.

8. Under new section 21(6)(b) (Page 77) of the Bill, the power of the Tribunal will be changed so that it will no longer be able to overrule the regulator's decision but simply:

> "[remit] the matter to the decision-maker with a direction to reconsider and reach a decision in accordance with the findings of the Tribunal."

9. We believe that this represents an unjustified diminution of the power of the Tribunal and the appeals process. The phrase "in accordance with the findings of the Tribunal" is broad enough to allow the FCA or PRA to depart from the Tribunal's findings.

Key Points

— 10. We believe that the Tribunal's powers should remain as they are under FSMA with the Tribunal able to overrule the decision of the FCA or PRA, rather than simply remit the decision back for reconsideration.

(ii) *Accountability*

11. The PRA is currently not subject to the same statutory accountability requirements as the FCA and the FSA.

Key Points

— 12. The PRA should be required to hold an annual public meeting with stakeholders, as the FSA is required.

— 13. To strengthen the PRA's requirement to engage with practitioners we believe that it should have a statutory practitioner panel with which it is required to consult on proposed rule changes. New section 2K(2) (clause 5) should be amended to provide that "the PRA's consultation requirements must include the establishment and maintenance of a practitioner panel to represent the interests of practitioners".

The Financial Conduct Authority (FCA)

14. We are supportive of the more proactive regulatory approach that the FCA is intended to apply to conduct regulation, but we believe that the FCA's powers and their safeguards could be strengthened.

(i) *Objectives and a Fiduciary Duty*

15. The Bill gives the FCA an operational objective to "secure an appropriate degree of protection for consumers." We support this objective; however, some have argued that the FCA should, in pursuit of this objective, place a fiduciary duty of care on firms.

16. We do not believe it would be appropriate for the Bill to place a fiduciary duty on financial services firms in this way because:

— 17. A fiduciary duty would place the full authority to transact on behalf of the customers with banks. This would remove responsibility from customers, create a situation where the customer no longer has any motivation to behave responsibly, and could make it harder to establish a relationship of mutual trust. Imposing a fiduciary duty would create an extreme imbalance in the share of responsibilities.

— 18. It is unlikely that a customer would understand the implications of a fiduciary duty, or would want to pass full responsibility to the bank if they did.

— 19. It is unrealistic to assume that a bank would be in a position to know what is in the interests of every individual customer at a given time.

Key Points

— 20. We believe that the Bill should be left unchanged from its present form, and no fiduciary duty should be placed on financial services firms as it is unnecessary and unworkable.

(ii) *Competition*

Fair Process

21. The Government has decided that the FCA should have a primary operational objective to promote "effective competition in the interests of consumers". This will effectively mean that the FCA will become the lead competition regulator in the UK, and it is therefore essential that the FCA's actions under its competition objective are subject to appropriate procedural and appellate safeguards. As currently drafted, it does not appear that there are any such safeguards in the Bill.

22. New section 138I (Page 93) sets out a general requirement for the FCA to consult on a draft of any proposed new rule and take account of representations made by third parties in response. However, the Bill gives the FCA wide discretion to dispense with these requirements. New Section 138L (Page 97) allows the FCA to disregard its requirement to consult whenever it considers that the delay involved "would be prejudicial to the interests of consumers". This is a very low threshold to set for dispensing with the right of interested parties to make representations before a decision is made, which is a basic and essential right of fair process. It is a much lower threshold than is applied to the other competition authorities such as the OFT and Competition Commission under the Enterprise Act 2002.

23. In addition, Section 395(2) of FSMA 2000 embodies the principle that regulatory cases should not be taken by individuals directly involved in establishing the evidence for that decision. The FSA set up the "Regulatory Decisions Committee" for this purpose. However, this section also gives the FSA the power to depart from this principle "if necessary to protect the interests of consumers". We believe that this should only be permitted in exceptional circumstances.

Key Points

— 24. The FCA should only be able to dispense with the requirements to consult in new Section 138I (Page 93) and the principles laid down in Section 395(2) of FSMA 2000 in exceptional circumstances where risk of harm to consumers outweighs the right of fair process.

Price Regulation

25. There is currently a lack of clarity as to whether the FCA will, under its competition objective, be able to consider the prices of products when determining whether a market is competitive. HM Treasury have stated that the FCA is not intended to be a price regulator like some utilities regulators. However, the FSA Approach Document on the FCA said that its powers will be exercised following an assessment of prices and charges. We are therefore concerned that the FCA could use its general rule-making powers to make price-related interventions. Absent clarity on the FCA's powers, there is a real risk of an increasingly uncertain environment with unintended consequences, including defensive firm behaviour which is damaging to the markets and consumers.

26. We believe that price regulation and controls could have an adverse impact on competition, innovation and choice for consumers. If products are transparent and easily comparable, competition between providers should keep prices low, without the need for price interventions.

Key Points

— 27. It should be written into the Bill that the FCA is not a price regulator in order to provide clarity to firms and the FCA.

(iii) *Product Intervention*

28. The FCA will have the power to issue permanent or temporary product intervention rules under the Bill. Under the temporary rule-making power the FCA will be able to ban a product for up to 12 months without consultation or cost-benefit analysis (Section 138M, Page 97). We believe that the safeguards currently proposed in the Bill are insufficient to ensure fair process.

Scope

29. The scope of this power is extremely broad. We therefore welcome the statement from the Government in the Treasury White Paper that it intends this power to be used "where it is appropriate and proportionate,

and where it will provide clarity to consumers and firms". However, this phrase does not appear anywhere in the Bill. Furthermore, the Bill currently allows the FCA to use its product intervention power in order to advance not just its "consumer protection" operational objective but also its "competition" operational objective.

Key Points

— 30. The Bill should include a clear statement that the FCA's product intervention power should be used "where it is appropriate and proportionate" and only in exceptional circumstances.

— 31. We believe the FCA should be able to exercise this power only under its "consumer protection" objective. This is because, as the Government has clearly stated, the purpose of this power is to protect consumers from products that are causing or are likely to cause mass consumer detriment. It is therefore logical that it should be exercised under the "consumer protection" objective.

— 32. The "competition" operational objective should be treated in the same way as the "integrity" operational objective—the FCA should only be able to exercise the product intervention power under either of them if the Treasury by order authorises it to do so.

Appeals and Consultations

33. There is currently no ability for firms to make representations to the FCA before it exercises the temporary product intervention power, nor is there any appeals mechanism for firms against a decision by the FCA to exercise this power, other than judicial review. In addition, the Bill states that the FCA will be able to make further temporary product intervention rules containing the same provision as a previous rule once a "prohibited period" of 12 months has elapsed since the initial rule expired (Section 138M (5) and (6), Page 98). This means that the FCA could, in theory, ban a product for 12 months, wait a further 12 months, and then ban the same product again, all without any consultation or cost-benefit analysis. We believe that this would be tantamount to exercising the permanent product intervention power but without the same safeguards.

Key Points

— 34. Firms should have the right to make representations to the FCA on a decision to exercise the product intervention power before it takes effect and the FCA should be required to take those representations into account, as opposed to "have regard" for them (New section 138I(3), Page 94).

— 35. There should be a clear mechanism through which firms can appeal against a decision by the FCA to exercise its permanent or temporary product intervention power written into the Bill, ideally through the Upper Tribunal. The Tribunal should be able to consider the underlying merits of a case.

— 36. We believe the "prohibited period" after which the FCA will be able to effectively re-issue a product intervention rule should be removed from the Bill. The FCA should instead be required to conduct a consultation and cost-benefit analysis during the initial period for which a product is banned. If the FCA decides as a result that it does not intend to make the temporary ban permanent, it should be required to discontinue the ban even if it has not yet expired. The FCA should only be able to reintroduce a temporary ban of a product that has already been subject to a previous ban if there has been a material change in circumstances.

(iv) *Financial Promotions Power*

37. We support the FCA's proposed financial promotions power but we believe that additional safeguards are required.

Key Points

— 38. We believe that there should be a formal requirement placed on the FCA in the Bill to consider and take into account the representations made by the person to whom the notice is given.

— 39. As currently drafted, the Bill allows the FCA to ban a financial promotion that has not yet been published if it believes it is likely to contravene financial promotions rules. We believe the FCA should only be able to do this if it believes the promotion would contravene the rules.

— 40. The Bill also requires the FCA to publish information about a direction to ban a promotion, even if the direction is revoked following consideration of representations. We believe this will inflict unjustified reputational damage on a firm. We believe the Bill should be amended to expressly prohibit the FCA from publishing information on a direction that has been revoked.

(v) *Early publication of disciplinary action*

41. The publication of an early enforcement warning notice could inflict significant unjustified reputational damage on a firm before it has the opportunity to challenge the accuracy of the facts. However, we accept that the Government is determined to give this power to the FCA and so we believe that there are some constructive amendments that could be made to the Bill to strengthen its safeguards.

Key Points

- 42. We believe that firms must be given the express right to comment on the notices and whether publication is appropriate (as opposed to simply being consulted) and the FCA should be required to consider and take into account those comments.
- 43. We also believe that if the FCA publishes a notice in spite of comments that it is not appropriate to do so, it should be required to explain why it is not unfair to proceed with publication.
- 44. We believe that when determining the fairness of publishing a notice, the FCA should be required to take into account indication of a challenge to the notice as well as reputational impact.
- 45. We also believe that provision should be made in the Bill to require the FCA to state in any information that it publishes that it is an early warning notice and the right to dispute has not yet been exhausted.

(vi) *Panels*

46. Under new Sections 1P and 1Q of Clause 5 (Page 22), the FCA will be required to set up a practitioner panel and consumer panel to represent the interests of these two groups. New Section 1R of Clause 5 (Page 23) will require the FCA to take these panels' representations into account and "from time to time publish in such a manner as it thinks fit responses to the representations".

47. We believe that these requirements are a dilution of the existing requirements currently placed on the FSA under FSMA 2000. Section 11(3) of FSMA states that "if the Authority [the FSA] 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". Under the Financial Services Bill, the FCA will be under no such duty to explain its reasons for disagreeing with a view or proposal from either of the Panels.

Key Points

- 48. We believe that the current wording under FSMA 2000 should be retained, and the FCA should be required, just as the FSA is, to provide a statement in writing of its reasons for disagreeing with a view or proposal from the Panels.

March 2012

Memorandum submitted by the Chair of Trustees, MK Money Lifeline (FS 12)

I'm writing as the Chair of Trustees of MK Money Lifeline, a newly formed Debt Advice service for Milton Keynes. The new trust was formed to take over the running of an organisation which was until January 2012 run under the aegis of New Life Church MK West, which has sadly come to an end. All of us were passionate about keeping the work going, so after a lot of work we have been able to form a company limited by guarantee which has set up the new trust (Registered Charity No 1146001, based as before in Acorn House CMK). I may write again about our vision, but meanwhile I am also writing as one of your constituents to let you know about my support for Amendment 87 to the Financial Services Bill currently being debated by Parliament. This would give the new financial regulators the ability to cap the excessive costs of credit and so help tackle legal loan sharking.

Giving these new powers to this body to address the conduct of this industry and the costs of financial products like payday loans would send a strong message to this industry about the rates of interest that are acceptable to charge. It could therefore make a real difference to the millions of Britons now struggling financially who are borrowing from these companies to make ends meet by encouraging firms to cut their charges.

Please co-sign Amendment 87 and encourage your colleagues who are on the committee to vote in favour of this amendment when it is debated in the coming days. The MPs on the committee are listed below for your information (*not printed*)—thank you in advance for your support for these proposals and the campaign to tackle legal loan sharking.

Thank you for your time.

March 2012

Memorandum submitted by the City of London (FS 13)

The Corporation contributed to the pre-legislative scrutiny of the draft Bill by the Joint Committee and circulated a briefing to a number of Members ahead of Second Reading. The City's interests in the Bill are therefore a matter of public record as part of the written evidence published alongside the Joint Committee's report. I shall not, therefore, repeat them in full. However, before the Public Bill Committee completes its consideration of the Bill, it may be useful for the Committee to have a summary of the issues raised by the City.

In its previous submissions, the City highlighted its strong belief in a regulatory structure for UK-based financial services that will enhance the stability of the financial system, restore public confidence and safeguard the competitiveness of the sector. Confidence in the financial services sector's ability to generate growth has been dented and maintaining the *status quo* in terms of financial supervision is not a realistic option. The need for adjustment to the regulatory framework is widely acknowledged as being necessary. Parts 1 and 2 of the Bill go some way to achieving this.

However, a particular concern aired was that, under what is now Clause 12, firms may be faced with being supervised by two separate regulators, since it appears that the authorisation of firms and individuals will be an overlapping responsibility between the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). There is also a risk in the new structure of separate and distinct rulebooks being produced by both the PRA and the FCA, and the City believes a single and consistent rulebook is essential for all regulated entities.

The Government consultation that preceded the Bill implied that the main dangers that the changes in regulatory structure were designed to address were bank or building society failures on the pattern of the events of 2007–08. There can, however, be occasional failures in the non-banking area of the financial services sector. Effective powers of intervention should be in place to resolve such crises, although in the event of the failure of a non-banking institution, the appropriate point of intervention will need to be identified at the time, rather than setting a mandatory defined threshold.

The proposed changes in the UK's regulatory structure will of course take place as rule-making powers move from domestic authorities to the new system of EU-wide supervisory institutions. The banking supervisor is based in London and it is essential that the new UK bodies, from the start, seek to influence the development of the EU-wide regulatory and supervisory structure, encourage secondments and develop a dialogue with equivalent bodies including those in the United States and the emerging financial centres of the Middle East and Asia. However, the UK authorities appear to be playing down the role of the ESAs, which could undermine the development of sound and effective regulation at the EU level if this results in the UK being less engaged.

The City has previously supported the requirement for the FCA (and other regulatory bodies) to have regard to the competitiveness of the UK financial service sector but this does not appear to be included in the current version of the Bill. Proper and effective regulation is essential for financial stability and both domestic and international trust and confidence and is the main mandate for the new authorities. It is however, important that they should share the responsibility of HM Treasury to promote the competitive position of the sector, as a major contributor to employment, export earnings and tax revenue. Domestic economic growth and the maintenance of the UK's global trading capacity require access to a competitive and liquid financial services sector. It is essential that the sector is not undermined by regulatory requirements and approaches which exceed in their prescriptive nature those of partners and competitors.

March 2012