A new approach to financial regulation: the blueprint for reform (Cm8083)

A response paper by the Futures and Options Association

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A NEW APPROACH TO FINANCIAL REGULATION: THE BLUEPRINT FOR REFORM (Cm8083)

1. Introduction

1.1 The FOA is the industry association for more than 160 firms and institutions which engage in derivatives business, particularly in relation to exchange-traded transactions, and whose membership includes banks, brokerage houses and other financial institutions, commodity trade houses, power and energy companies, exchanges and clearing houses, as well as a number of firms and organisations supplying services into the futures and options sector (see Appendix 1).

1.2 The FOA welcomes the recognition in the HM Treasury consultation paper %A new approach to financial regulation: the blueprint for reform+ (hereinafter %Cm8083+):

(a) that *"financial services is one of the key sectors of the UK economy"* and *"as an employer and contributor of tax revenues, as an exporter of UK services to the rest of the world, and as a vital part of the economic infrastructure, a healthy financial sector is an important driver of growth in the UK"* (para 1.1);

(b) that the potential for significant risks posed by such a financial service sector and the severe impact of the recent financial crisis calls for the kind of *"targeted policy responses"* identified in para 1.5 and a fundamental strengthening of the system *"by promoting the role of judgement and expertise"* (para 1.13); and

(c) that, in order to develop an appropriate and workable programme of reform, the Government must *"work closely with all stakeholders"* (para 1.15).

1.3 With regard to the burden of regulation, the FOA would reiterate the Governmentqs assertions in its previous consultation paper %A new approach to financial regulation: building a stronger system+ (Cm8012), namely:

(a) that a key priority will be *"reducing the burden of regulation and improving the quality of regulation"* (paras 3.66-7);

(b) that policy-makers must *"think carefully about the case for regulation"*, and where intervention is required, to explore in full the opportunity for non-regulatory and self-regulatory approaches before considering regulatory measures (paras 3.66-7);

(c) that the new regulators must be *"rigorous in their analysis of the impact of regulation on industry"* (para 3.67);

(d) that it will be part of the FCAqs role to remove regulatory barriers, where possible, to facilitate greater efficiency and choice and that this is *"clearly an issue of primary importance along the whole financial value chain and for all consumers of financial services"* (paras 4.15);

(e) that regard should be paid to the *“potentially negative effects of excessive regulation on market efficiency and consumer choice”* (para 4.9); and

(f) that the new infrastructure must be able to operate in a way that delivers coherence, efficiency, effectiveness and *“the best value-for-money solution for the financial services sector”* (%A new approach to financial regulation: judgement, focus and stability+(Cm7874)).

The FOA hopes and anticipates that these key expressions of regulatory policy and proportionality will be properly reflected %on the ground+by both the PRA and the FCA as they develop their regulatory policies and practices. Unfortunately, however, there seems to be little real recognition of the Governmentœ intention that the new approach to regulation should avoid excessive regulation and constitute a %value-for-money+ proposition in FSAœ recent Discussion Paper %The Financial Conduct Authority: Approach to Regulation+(June 2011). There is, clearly, an inherent conflict between the policy objectives expressed above and the drive for closer, higher cost and more interventionist regulation. Hence, the FOAœ emphasis on facilitating competitiveness, as set out in para 1.4 in this response.

1.4 The FOA strongly supports the six statutory regulatory principles set out in the draft Bill, but in order to deliver the financial service sector contributions and the regulatory objectives set out in paras 1.2 and 1.3 respectively in this response, the FOA would urge the Government to reconsider its position regarding the importance of competitiveness and include its facilitation as a factor required to be taken into account by the PRA/FCA (see further paras 3.4 and 4.13 in this response).

1.5 The FOA welcomes the Governmentœ firm intention to ensure that there is full and effective co-ordination between the various bodies that have macro- or micro-supervisory responsibilities. This means:

(a) the development of %bright lines+, where possible, in terms of scope, responsibilities and decision-making . all of which are critical to ensuring the delivery of regulatory efficiency and the avoidance of unnecessary regulatory duplication, particularly for dual-regulated firms;

(b) that the decision-making process and the individual objectives and responsibilities and how the common regulatory principles are applied by the different authorities are properly understood and taken into full consideration by each of them (recognising the failures in the pre-crisis Tripartite arrangement) . as required by s.9E(2) of the draft Bill to the FPC in relation to its objectives.

1.6 The FOA strongly supports the view that, irrespective of the category of customer, financial service providers should be required to act fairly and honestly, but believes that expectation of high behavioural standards should not result in wholesale business being subjected to inappropriate, high-cost retail-style protections.

The FOA welcomes, therefore, the observation in HM Treasuryœ Cm8012, that *“there are wholesale and market activities which do not directly form part of the transaction chain of products and services sold to retail customers. The scale and importance of these activities makes it imperative that they are effectively and proportionately*

regulated in a way which recognises the particular characteristics of participants in these markets" (para 1.39).

This view is reflected by the FSA in its recent Discussion Paper (referenced in para 1.3 above), insofar as it recognises that there are important differences between wholesale and retail markets and that financially sophisticated consumers do not require the same degree of protection as retail consumers (paras 3.5 and 3.6 in the DP), but the FOA remains concerned that there may still be some retail scope-creep into the regulation of wholesale business.

1.7 Statutory immunity removes the inherent legal right of persons to be able to bring civil proceedings for damages in the event of negligence.

In view of the potentially very high reputation and commercial consequences for firms that could flow from a significantly more commercially interventionist regulatory authority (e.g. in relation to product intervention, the issuance of notices warning of disciplinary action, powers to intervene in the commercial strategy and operation of regulated firms and FCAqs new role in competition, etc.), the FOA believes:

(a) that the current scope of application of statutory immunity applicable to FSA should be reviewed, to ensure that it continues to be fair and proportionate in the context of the FCA and these new powers;

(b) that the powers of the Complaints Commissioner should be strengthened in order to serve as a more effective discipline on the exercise of these new powers; and/or

(c) that there should be some form of independent oversight of the exercise of the FCAqs decision-making processes in highly sensitive commercial areas to ensure there is no undue significant commercial detriment and that FCA decisions in this area are viewed not just through a %consumer prism+ (see para 4.1 in this response), but also an economic prism.

1.8 The FOA strongly supports the intention to review the funding methodology that lies behind the compensation regime of the Financial Services Compensation Scheme (FSCS), bearing in mind that some firms bear a disproportionate level of contribution when measured against the risk of claim that they pose to the scheme.

1.9 The FOA has commented on the draft Bill in the sections below and also in Appendix 2.

2. Responses to White Paper Questions on the Financial Policy Committee (FPC)

Q1. Do you have any specific views on the proposals for the FPC as described above and in Chapters 3 and 4?

2.1 The FOA supports the Government view:

(a) that the FPCqs primary objective is to identify, monitor and take action to remove or reduce systemic risk that could threaten the UK financial system;

(b) that this objective should take into full account the need to avoid any adverse impact on the ability of the financial sector *“to contribute to the UK economy in the medium or long term”* (para 2.8);

(c) that the factors to be taken into account by the FPC should include proportionality, openness and international law (as set out on Clause 3 of the draft Bill);

(d) that HM Treasury should be empowered to suggest other factors that might be considered by the FPC in the exercise of its functions (but questions whether the FPC's ability *“to reject any recommendations with which it does not agree”* (para 2.12) creates a conflict here and, if so, how that conflict will be resolved?);

(e) that in principle, *in extremis,* HM Treasury should have the power to bring into force new tools expediently but that this power enabling Parliament to be bypassed (as set out under 9L(2)) should be more tightly circumscribed than by “*reason of urgency*”, to reflect that Parliamentary scrutiny should occur in all except the most necessary of situations.

(f) as observed in para 2.17, that the FPC should have appropriate *“discretion in the use of macro-prudential tools”* but would note that the exercise of individual state discretions in this area could be in conflict with the powers exercisable by the new European Authorities and could create problems for regional coherence on actions required to reduce regional systemic risk; and

(g) that the FPC will be required to take economic growth into account in pursuing financial stability, but would emphasise that actions taken in pursuance of sustaining financial stability should also take into account their social impact and consequences.

NB As a general observation, these factors do not appear to apply to the Bank of England when considering the recommendations of the FPC.

2.2 The FOA would reiterate its view, as noted in para 2.18 of Cm8083, that governance of the FPC is *“too heavily weighted”* towards the Bank and that this must be offset by having an adequate number of external members with appropriate expertise. The FOA welcomes the Government's intention to give this concern further consideration over the period of pre-legislative scrutiny and notes that the Bank's governance will be adjusted by the amendments proposed in para 2.31. In particular, we would highlight that we are not of the view that the CEO of the FCA should not be regarded as an external member.

The FOA would also propose that to avoid duplicative requests for information being made to firms, the FPC should be under an obligation, as is the European Systemic Risk Board, to first take into account information held by the FCA and PRA, prior to making the request. Such a requirement could be framed in a form consistent with Article 15, *Collection and exchange of information,* of the ESRB's founding Regulation (No 1092/2010) which sets out safeguards with regard to collecting information to avoid such duplication.

Q2. Do you have any specific views on the proposals for the Bank of England's regulation of RCHs, settlement and payment systems as described above and in Chapters 3 and 4?

2.3 With regard to the regulation of RCHs, the FOA supports the measures set out in para 2.35 and:

(a) anticipates that the checks and balances, accountabilities and factors that apply to the PRA in terms of its regulation and supervision of systemically-important institutions, will apply equally (adjusted for relevance) to the Bank of England; and

(b) welcomes the requirement for the Bank and for FCA to enter into an MOU as set out in s.25 of the draft Bill and assumes that the methodologies and processes for PRA co-ordination with the FCA as the licensing authority of exchanges will apply with equal measure to the Bank of England, taking into account that CCPs are now largely integrated within exchanges – generating for exchanges the cost and burden of dual recognition.

Q3. Do you have any comments on:

- *the proposed crisis management arrangements; and*

- *the proposals for minor and technical changes to the Special Resolution Regime as described above and in Chapters 3 and 4?*

2.4 With regard to the crisis management arrangements, we would reiterate our previous comments that, as the PRA will have responsibility for triggering a failing firm's entry into the BoE's special resolution regime and for investigating and reporting to Treasury where there has been a possible regulatory failure, we are concerned that these roles potentially represent a structural conflict in the PRA's operation: the PRA may be hesitant to trigger the special resolution regime or report on a possible failure as having to take either step may represent a supervisory failure on the PRA's part**.** Similarly, as the draft Bill also requires the FCA to investigate and report on possible regulatory failures, we would highlight that the same potential conflict exists for the FCA in that it could conceivably hesitate to investigate for fear of generating criticism.

3. Responses to White Paper Questions on the Prudential Regulation Authority (PRA)

Q4. Do you have any comments on the objectives and scope of the PRA, as described above and in Chapters 3 and 4?

3.1 With regard to the Treasury's power to set additional specific objectives in future, the FOA believes that this may be driven by experience in terms of the operation, policy and processes of the PRA and not just *"as a result of the future widening of the responsibilities of the PRA"* (para 2.47). The FOA believes this is an undesirable constraint on this proposed power of HM Treasury.

3.2 The FOA welcomes the additions made to the PRA objective as set out in para 2.48, which acknowledges the importance of recognising diversity in firms and regulated activities, but would emphasise that this recognition of the need for differentiation should be extended to products and not just restricted to firms and services.

3.3 The FOA supports:

(a) recognition in Cm8083 of the need for regulatory policy and processes to be appropriately tailored to different types of firms; and

(b) rejection of a *"zero-failure"* approach to regulation, which would have to be so restrictive in terms of risk, innovation and choice as to undermine the Government's recognition in para 1.1 that *"a healthy financial sector is an important driver of growth in the UK"*.

This rejection of a "zero failure" approach has been emphasised by Hector Sants, Chief Executive, FSA, in his speech to the British Bankers Association on 7th March 2011, in which he stated that:

"The FCA will not be a "no failure" institution. Removing all risk-taking from consumers would remove individual freedom of choice and considerable benefits to society."

3.4 With regard to competitiveness, the FOA agrees with the view expressed in para 2.51 that financial stability is the platform for sustainable growth and success, but not that this obviates the need for a specific statutory principal requiring the regulatory authorities to pay due regard to the need to facilitate competitiveness. Indeed, an unduly prescriptive approach to sustaining financial stability could reduce the competitiveness of the sector.

As the Government has rightly observed in the Introduction to Cm8083, the financial services sector is *"one of the key sectors of the UK economy"* and *"an exporter of UK services to the rest of the world"*. Both these objective are heavily dependent on the industry being allowed to be strongly competitive in what is a highly competitive economic sector. While it is recognised that the degree to which systemically important institutions can be competitive must be tempered by the fact that they are systemically important, the PRA should be required to pay proper regard to the need for firms regulated by it to be internationally competitive.

It is difficult to see how both the PRA and the FCA can perform the more commercially judgemental and interventionist role that is expected of them – and which will involve taking decisions on commercial matters, reviewing business models and products and judging growth strategies – without being required to take into full account the need for those same institutions to maintain not just their international, but also their domestic, competitiveness.

3.5 The FOA:

(a) agrees that the PRA's ability to designate firms that will fall within its scope should be subject to a number of procedural safeguards including (as stated in para 3.26 of Cm8012), obligations to consult with the FCA in making this determination,

providing firms with an opportunity to make representations and subjecting a designation decision to a right of appeal by a designated firm; and

(b) believes that the *"designation criteria"* should be transparent and applied and implemented consistently.

The FOA would, however, highlight a key concern with regard to its understanding that members of the same group will not necessarily be prudentially supervised by the same regulator. We strongly support an approach whereby there is one prudential supervisor for a group so that where one group firm is PRA authorised, the PRA is the prudential regulator for all firms within that group. A single prudential regulator for all group firms will ensure consistent prudential oversight, minimise the regulatory burden for firms and is particularly desirable given that HM Treasury has confirmed the PRA and FCA will have separately drafted prudential rulebooks.

Q5. Do you have any comments on the detailed arrangements for the PRA described above and in Chapters 3 and 4?

3.6 The FOA welcomes the adoption of a *"judgement-led"* approach to regulation, but would reiterate the importance of recognising:

(a) that all such judgements should be *"rigorously evidence-based"*;

(b) that judgements should be made according to criteria that facilitate consistency of decisions in comparable sets of circumstances;

(c) that the establishment of transparent and predictive criteria would enable firms to better understand the consequences of their actions;

(d) the importance of effective information-sharing with the FCA, where judgement-led decisions of the PRA are or could be relevant, or applicable in similar sets of circumstances which fall within the scope of the FCA, which has affirmed its intention to continue to be a principles-based, as well as a rules-based authority.

3.7 The FOA welcomes the Governmentqs decision not to narrow the grounds of appeal to the Tribunal as regards its scope in reviewing supervisory decisions. With regard to the Governmentqs decision not to allow the Tribunal to substitute its opinion for that of the regulator in the event of an appeal, the FOA believes that this should be subject to a requirement that the PRA give full and reasonable consideration to any directions issued by the Tribunal and the provision of a statement of reasons where it does not accept those directions, in order to ensure that the Tribunal is not perceived as a %toothless tiger+.

NB. These observations on the role of the Tribunal apply equally to the FCA (See para 4.14 in this response).

3.8 The FOA welcomes the Governmentqs assurance that *"the PRA board must provide a robust challenge to the executive"* and that means that the same standards of challenge that are expected of non-executives sitting on commercial boards should apply with equal rigour to their role on regulatory boards.

NB. This Board obligation applies equally to the FCA (see para 4.18 in this response).

3.9 The FOA supports the proposal that the National Audit Office should undertake value-for-money studies of the PRA and other authorities, including the FCA (see para 4.20 in this response). However, this audit function should cover the setting of fees by the CPMA and the PRA to avoid unnecessary regulatory duplication or a disproportionate impact on the economic delivery of financial products and services, particularly applicable in the case of dual-regulated firms. This would also help to ensure that sufficient regard is paid by the PRA and the FCA to the cost-effectiveness and %value-for-money+priority for regulation, which was identified by HM Treasury in Cm7874 and Cm8012 (see para 1.3 in this response).

3.10 With regard to the proposals for a PRA complaints scheme, the FOA would reiterate its observations that the proximity between the role of the Bank of England and the PRA could raise perceptions about a lack of independence in dealing with complaints . even in the area of operational matters. The FOA welcomes the Governmentqs assurance that the complaints scheme run by the Bank of England will be *"suitably transparent and robust"*, but it must also demonstrate a satisfactory degree of independence. For this reason, the FOA would argue that complaints about the PRA should fall within the jurisdiction of the Complaints Commissioner, as is currently the case with the FSA and will be the case as regards the FCA . particularly since no clear reason is given in Cm8083 as to why complaints against the PRA should be handled any differently.

3.11 The FOA continues to feel strongly that the PRA should work with a Practitioner Panel that is comparable to the existing Panel set up under the FSMA, albeit comprising panellists with expert knowledge and experience relevant to the scope and objectives of the PRA, e.g. particularly in the area of prudential regulation of systemically-important institutions.

The FOA would emphasise that the current establishment of the existing Practitioner Panel by the FSMA 2000 was to compensate the regulated community for the fact that, while they were paying for regulation, they would no longer have the same policy input as they did in the time of self-regulation and therefore it should be represented by a high level statutory panel. That same argument is equally applicable in the case of the establishment of the PRA. In other words, in the view of the FOA, it is not acceptable that the PRA should have sole discretion, as described in para 2.77, as to *"what kind of arrangements it wants to establish for engaging with industry"*. The assurances and objectives (and, indeed, the rights of the industry which continues to pay for regulation) underpin the purpose of establishment of a statutory Practitioner Panel and apply with equal force to the PRA as they did to the FSA and as they will do to the FCA.

While the FOA supported the Governmentqs position not to establish a PRA Consumer Panel, largely because of the obligation on the PRA to consult with the FCA where any of its decisions will have a material impact on consumers, the FOA would continue to urge the Government to give fresh consideration to the importance of establishing a Practitioner Panel in relation to the role of the PRA and use more forceful language in s. 2J(2) than the PRA %may include+the establishment of such a panel.

3.12 The FOA believes that the power of review by an independent person should include the additional factors set out in relation to the FCA at the end of para 4.1.8 in this response.

4. Responses to White Paper Questions on the Financial Conduct Authority (FCA)

Q6. Do you have any views on the FCA's objectives – including its competition remit – as set out above and in Chapters 3 and 4?

4.1 The FOA welcomes the Government's renaming of what is now the Financial Conduct Authority and the importance of clarifying what was meant by *"a strong consumer champion"*. However, since the FSA has repeatedly emphasised that it will be assessing its role through a *"consumer prism"* and the FSA's DP appears to address *"judgemental offsets"* in the context only of consumers, there is a risk that a proper balance might not be preserved as between the interests of consumers and regulated service providers. For this reason, the FOA would urge HM Treasury to ensure that there is a continuing and objective balance in the role and processes of the FCA with regard to both regulated firms and customers. This is not to state that the FOA quarrels with the fact that investor protection and consumer interest should be a priority, but rather that it should not become the sole perspective of the FCA to the point where it may, even inadvertently, result in the unfair treatment of regulated firms.

4.2 The FOA welcomes the proposal that the FCA will have a strong new role in promoting competition, efficiency and choice and notes the Government's recognition of *"the importance of competition as the best driver of good consumer outcomes"* and its intention to *"increase the profile of competition issues in a regulatory system"* (paras 1.8 and 1.41).

In particular, the FOA notes the Government's intention:

(a) to empower the Office of Fair Trading to consider to what extent competitive inefficiencies in specific markets are generated by structural barriers or other anti-competitive elements (paras 1.8 and 1.41);

(b) to give the FCA a wide-ranging competition mandate *"which will place competition concerns at the heart of the new conduct regime"*;

(c) to empower the FCA to initiate *"an enhanced referral to the OFT where it has identified a possible competition issue"*, including issues that may be generated by structural market features or anti-competitive business practices (identified in relation to Q10).

4.3 Increasing consolidation in the financial services sector means that fewer participants are providing key products and services. In this environment, it is vital for regulators to ensure that market dominance (wherever the source) is not anti-competitive and does not result in abuse of consumers. The FOA is supportive of the FCA being given a specific obligation to discharge its general functions in a way that promotes competition, including focussing on market power and prices. Empowering the FCA to independently monitor the behaviours of market players relevant to market

competitiveness and (as set out in s.1E of the draft Bill) efficiency and choice in market services will be a critically important discipline on entities with considerable market power, and will play a key role in delivering on FCA objectives of market integrity and efficiency. However, we strongly support statements from both HM Treasury and the FSA that the FCA should not be a pricing regulator.

4.4 In this context, the FOA notes that the FCA will be assuming a more commercially interventionist and economic and competition-related role, in terms of monitoring remuneration and intervening in the development, distribution and pricing of products.

In addressing the BBA Annual Conference on 29th June 2011, Hector Sants, Chief Executive, FSA, noted that, while the Government is not expecting the FCA to become an economic regulator, it *"is expecting it to utilise its powers to make judgements on pricing issues where they relate to fairness. Delivering on this mandate will require a step-change relevant to the FSA and the FCA's technical skills and philosophy."*

Further, the FSA, in its June 2011 publication %Approach to Regulation+, stated that the FCA will be focussing more directly on the workings of the markets *"including market power"* and that the regulatory options which will be available to it will include *"measures which reduce market power"* and *"price intervention"* (paras 3.14-5)

4.5 The FOA welcomes the Governmentqs assurance that it will keep this requirement under consideration as part of *"this phase of pre-legislative scrutiny"*.

4.6 In the matter of the FCA being required to facilitate competitiveness as a factor to be taken into account in fulfilling its objectives, the FOA would repeat all the observations made by it in urging that a similar factor should be applied to the PRA in terms of fulfilling its objectives (see para 3.4).

While the prudential regulation of international systemically important institutions by the PRA should be required to consider the need to sustain international competitiveness, this is also a key factor that should be taken into account by the FCA, firstly, because it is setting the business conduct rules of those same international institutions; and, secondly, it will be responsible for the business conduct and prudential regulation of small firms, the competitiveness of which, in a domestic context, will be equally important insofar as they are often associated with the %green shoots of recovery+.

Q7. Do you have any views on the proactive regulatory approach of the FCA, detailed above and in Chapters 3 and 4?

4.7 The FOA supports the need for a more proactive approach to conduct regulation with a *"clear focus on consumer outcomes"*, but subject to standards of proportionality which would reflect:

(a) the category of consumer, e.g. retail or wholesale; and

(b) the need for firms to be competitive and pro-active in terms of service and product innovation in what is a highly competitive environment.

4.8 The FOA supports the proposed new powers of intervention to be given to the FCA in relation to products.

However, in view of the potentially significant impact that their exercise could have on firms, consumers and markets, they should:

(a) only be exercised where there is a real and demonstrable risk of *"significant consumer detriment"* and this is demonstrated by the examples given in the DP of retail consumer detriment in Chapter 5, insofar as they represent large-scale losses, indicating that the scale of anticipated detriment will be key to justifying use of the FCAqs product intervention powers;

(b) *"strike the right balance between consumer protection… and the risks of restricting consumer choice and product innovation"* (para 1.24 of FSAqs Discussion Paper %Product Intervention+(DP11/1));

(c) be subject to safeguards to ensure due consideration is given to conflicting public policy interests, i.e. that *"an appropriate balance is struck between the interests of consumers and regulated firms"* (para 4.76 in DP11/1);

(d) be exercisable only in accordance with clear and transparent policy criteria to enable firms to have a reasonable degree of certainty over the regulatory position as regards the development of new products; and

(e) not become, as it is put in Cm8083, *"a substitute for regulation of the sales process"* (para 2.99), i.e. when a product is sold it is a business conduct, not product quality, issue, yet FSA continues to state that one justification for banning a product could be the level of perceived risk of mis-selling.

The FOA notes and supports the Governmentqs observation in Cm8012 that such interventionist powers are *"unlikely to be appropriate in relation to professional wholesale consumers"*. However, the FOA also notes the observations by the FSA in in its %Approach to Regulation+that product intervention must still be considered *"to the extent that wholesale products filter down or are distributed to retail consumers"* (para 5.26). The FOA understands this qualification, but would urge that it does not undermine the Governmentqs view that this should not normally be applicable to professional wholesale customers.

The FOA also notes that the draft Bill enables the FCA to immediately ban a product without consultation for up to 12 months where %*necessary or expedient*+ which it considers too wide a test and that the normal process of consultation should be bypassed in emergency situations only. The FOA also believes that a process should be established to enable firms to appeal against a ban and would suggest the Bill to be amended accordingly.

4.9 With regard to early publication of disciplinary action, while the FOA welcomes the Governmentqs recognition of the need for safeguards, it would nevertheless urge the Government to reconsider its position on this issue. At the very least, the proposed safeguards should:

(a) not just allow a firm that is to be the subject of any such notice to comment on its wording prior to publication, but require the FCA to take any such comments into full consideration;

(b) require the FCA to set out in any notice, however briefly, the firmsqdefence to the allegation in question, recognising that there has been no finding of guilt, and that there is an overriding obligation for fairness in public disclosures of this nature.

NB. It should be remembered that the issuance of such notices, no matter how much reputational damage may be caused and no matter how inadequate the evidence founding the allegation in question, will be protected by statutory immunity (see para 1.7 in this response) and that this should place a very high duty of care on the FCA in terms of taking actions that could generate serious commercial loss and loss of reputation to firms.

While the FOA supports the obligation on the FCA to publish, as appropriate, a Notice of Discontinuance, this will do little to correct any damage that may have been caused to the reputation, jobs and share price of the firm in question. The FOA believes strongly that there should be some form of independent scrutiny to ensure that conflicts of interest between the public and private interest are properly addressed, including analysis of the evidence supporting the decision . as well as the decision itself . to issue a notice.

Q8. What are your views on the proposal to allow nominated parties to refer to the FCA issues that may be causing mass detriment?

4.10 The FOA agrees that the FCAqs powers of early intervention will, as is stated in Box 2.H, *"reduce the occurrence of the types of mass detriment seen over the past decade"*. However, it is important that the proposal to allow nominated parties to raise issues with the FCA of potential mass detriment are subject to a number of checks and balances, e.g. that the power is confined to credible and properly accountable groups:

(a) bearing in mind the potential for unjustifiable reputational risk to any named firm;

(b) to prevent the FCA being locked into a series of potentially costly, protracted and controversial procedures and processes without good cause;

(c) to reduce the risk of reporting abuse, the submission of vexatious reports and unwarranted attacks on the reputation of firms.

Q9. What are your views on the proposal to require the FCA to set out its decision on whether a particular issue or product may be causing mass detriment and preferred course of action, and, in the case of referrals from nominated parties, to do so within a set period of time?

4.11 The FOA has no particular concern over the procedural requirements following a report of possible mass detriment, providing, where a firm or group of firms is involved,

they are given a full right of response before any public steps are taken, and that the FCA is under an obligation to take that response into full consideration in deciding what action, particularly if it is of a public nature, is to be taken. In terms of establishing time limits, it is essential that compliance with a timetable does not take precedence over the need for a full and proper investigation into the merits of a report.

Q10. Do you have any comments on the competition proposals of for the FCA set out above and in Chapters 3 and 4?

4.12 The FOA refers to its response to Q6 and, in particular, paras 4.2-4.4 in this response.

4.13 The FOA repeats its opposition to the Governmentqs view that the FCA should not be subject to a %competitiveness+factor (see para 4.6 in this response) for reasons set out in relation to the PRA (see para 3.4 in this response).

4.14 The FOA repeats its observations about the role of the Tribunal in para 3.7 in this response, insofar as they should apply not just to the PRA, but also to the FCA.

Q.11 Do you have any views on the proposals for markets regulation by the FCA, described above and in Chapters 3 and 4?

4.15 The FOA welcomes the fact that the approach to the supervision of markets by the FCA will largely be a continuance of the same approach currently adopted by the FCA, and that its primary focus will be on the integrity and efficiency of markets and providing a level playing field for market participants.

4.16 The FOA notes that the primary focus will be on market infrastructures, but would emphasise the importance of the provision of technology services, not just to the markets, but also to financial intermediaries and their customers in terms of assuring market integrity, market connectivity and risk mitigation.

Q12. Do you have any comments on the governance accountability and transparency arrangements proposed for the FCA, as described above and in Chapters 3 and 4?

4.17 The FOA welcomes the proposals put forward by the Government, including particularly the proposed six principles of good regulation to which the FCA must have regard, i.e. efficient use of resources, regulatory proportionality, consumer responsibility, senior management responsibility, openness and transparency.

The FOA also supports the mechanisms for FCA accountability to Government and Parliament, the role of the FCA Board in terms of providing a robust challenge to the Executive (see also para 3.8 in this response) and the requirement on the FCA Board (and the PRA Board) to observe good corporate governance standards as set out in s.3C of the draft Bill.

The provision for review by *"an independent person"* into the economy, efficiency and effectiveness with which the FCA has used its resources to fulfil its obligations under s.1N of the draft Bill should be extended to include (a) the extent to which it has

utilised cost-benefit, market and other analyses to justify its decisions; and (b) the extent to which the principles for good regulation have been observed in discharging its responsibilities.

4.18 The FCA has provided the assurance that its judgements will be *"reasonable and proportionate"* (para 4.18 in FSAq¢ %Approach to Regulation+), but the FOA supports the fact that its regulatory decisions will nevertheless be subject to an effective appeals mechanism, e.g. the scrutiny of an Independent Tribunal.

4.19 The FOA would repeat its observations about the scope and role of the National Audit Office as playing a key part in ensuring regulatory efficiency, not just for the PRA, but also the FCA (see para 3.9 in this response).

4.20 The FOA welcomes the provisions in s.17 of the draft Bill covering the investigation of complaints against the FCA, but believes that s.17(6) of the draft Bill should require the FCA to give a statement of reasons where it decides not to follow a recommendation.

Q13. Do you have any comments on the general co-ordination arrangements for the PRA and FCA described above and in Chapters 3 and 4?

4.21 The FOA would reiterate observations made earlier in this response regarding the need for effective co-ordination and welcomes the fact that the Bank and FCA will be publishing a document later this year setting out more fully their plans to deliver *"operational co-ordination"* and that a key purpose of the general duty to co-ordinate is to *"minimise unnecessary overlap, duplication and regulatory burden"*.

The FOA would emphasise that operational co-ordination and the avoidance of unnecessary overlap is as much in the interest of the regulatory authorities themselves and the customers of regulated firms as it is of the regulated firms and that, in a climate of escalating regulatory cost (which will be borne essentially by consumers of financial services), this should be a particularly important objective.

4.22 The FOA agrees that there should be a *"high threshold"* for the use of the PRA veto and that there should be clear and transparent criteria surrounding its use.

5. Responses to White Paper Questions on other issues

Q14. Do you have any views on the detail of specific regulatory processes involving the PRA and FCA, as described above and in Chapters 3 and 4?

5.1 The FOA generally supports the regulatory processes set out in this section of Cm8083, but

(a) with regard to para 2.183, if PRA/FCA powers to retain original documents result in them being retained by the regulatory authority for excessive periods of time, the authorities should be required to provide a statement of reasons to the owner of the documents . and this would act as an essential discipline to ensure that the authoritiesqown procedures are appropriately expedited and that the documents are retained for no longer than is necessary;

(b) with regard to the issue of enforcement, there is a clear tension between the FSA's understandable drive to develop credible deterrence sanctioning, the principle that the punishment should fit the crime, i.e. sanctioning proportionality, and the right of individuals to be able to reasonably predict the consequences of their actions. This means that there should be transparent governing criteria around the sanctioning policy and process of the FSA to ensure that these issues are properly addressed in a balanced way and that any significant increase in sanctions should be made only on reasonable and public notice of an increase.

5.2 The FOA believes that the reduction in the minimum period for representations to be made from 28 days to 14 days would be acceptable in very straightforward cases, but:

(a) the Government should also pay attention to the regulators' own protracted processes, which have contributed significantly to slowing down *"the enforcement process unnecessarily"*, i.e. there needs to be even-handedness in this area;

(b) while the relevant authority will be able to exercise discretion in specifying a longer period on an individual basis, respondents should be able to apply for longer periods of time and the relevant regulatory authority should be required to give full and fair consideration to any such application, bearing in mind that it is the respondent who will be best-placed to determine how much time may be necessary in order for it to make individual representations.

5.3 The safeguard set out in para 2.188 of Cm8083 regarding the publication of information should be extended beyond the avoidance of undermining *"consumer interests or financial stability"* to include the legitimate interests of a regulated firm.

The FOA remains concerned that the proposed processes for approved persons' applications are unclear and require further development. In particular, the Blueprint refers to "*the Government remains of the view that one authority should have a deciding say in the application process*" (pg 43); however, the draft legislation indicates that applications for approval should go to the two Regulators separately. The FOA would seek further clarity regarding this matter.

We also note the new section 166A ('S166A) (inserted by schedule 11 to the draft Bill) which will enable the PRA and the FPC to require a firm to appoint a skilled person to "*collect and keep up to date*" information where an authorised person has contravened a rule which requires it to collect and update information. Although the FOA surmises that s166A has most obvious application to recovery and resolution plans, it is concerned that as it is drafted widely, the power could provide for a skilled person to be appointed to collect and maintain data on an ongoing basis. Consequently, the FOA seeks additional clarification and safeguards regarding the purpose and use of this proposed power.

5.4 With regard to information gateways and information-sharing, it is important that the UK regulatory authorities seek a full statement of reasons, prior to disclosure, as to the basis on which information is being sought:

(a) to avoid "fishing expeditions";

(b) to know by what authority the requesting organisation is demanding disclosure;

(c) to ensure that the requesting authority is seeking information for itself and not as agent for an associated organisation which does not have the authority to obtain the information in question;

(d) to ensure that the disclosure of the information in question will not put companies or individuals at unacceptable levels of risk in jurisdictions with questionable human rights and/or legal safeguards.

Q15. Do you have any comments on the proposals for the FSCS and FOS set out above and in Chapters 3 and 4?

5.5 The FOA has no comments, other than its support for the concern of some of its members over the extent of their liability to contribute to the FSCS, which should be, but is not, linked to the claims risk of each contributor. The FOA welcomes, therefore, the intended review of the FSCS.

APPENDIX 1

LIST OF FOA MEMBERS

FINANCIAL INSTITUTIONS

ABN AMRO Clearing Bank N.V.
ADM Investor Services International Ltd
Altura Markets S.A./S.V
Ambrian Commodities Ltd
AMT Futures Limited
Bache Commodities Limited
Banco Santander
Bank of America Merrill Lynch
Banca IMI S.p.A.
Barclays Capital
Berkeley Futures Ltd
BGC International
BHF Aktiengesellschaft
BNP Paribas Commodity Futures Limited
BNY Mellon Clearing International Limited
Capital Spreads
Citadel Derivatives Group (Europe) Limited
Citigroup
City Index Limited
CMC Group Plc
Commerzbank AG
Crédit Agricole CIB
Credit Suisse Securities (Europe) Limited
Deutsche Bank AG
ETX Capital
Fortis Bank Global Clearing NV - London
GFI Securities Limited
GFT Global Markets UK Ltd
Goldman Sachs International
HSBC Bank Plc
ICAP Securities Limited
IG Group Holdings Plc
Investec Bank (UK) Limited
JP Morgan Securities Ltd
Liquid Capital Markets Ltd
Macquarie Bank Limited
Mako Global Derivatives Limited
MF Global
Marex Financial Limited
Mitsubishi UFJ Securities International Plc
Mizuho Securities USA, Inc London
Monument Securities Limited
Morgan Stanley & Co International Limited
Newedge Group (UK Branch)
Nomura International Plc
ODL Securities Limited
Rabobank International
RBS Greenwich Futures
Royal Bank of Canada
Saxo Bank A/S
S E B Futures
Schneider Trading Associates Limited
S G London
Standard Bank Plc
Standard Chartered Bank (SCB)
Starmark Trading Limited
State Street GMBH London Branch
The Bank of Nova Scotia
The Kyte Group Limited
Tullett Prebon (Securities) Ltd
UBS Limited
Vantage Capital Markets LLP
Wells Fargo Securities International Limited
WorldSpreads Limited

EXCHANGE/CLEARING HOUSES

APX Group
Bahrain Financial Exchange
CME Group, Inc.
Dalian Commodity Exchange
European Energy Exchange AG
Global Board of Trade Ltd
ICE Futures Europe
LCH.Clearnet Group
MEFF RV
Nord Pool Spot AS
NYSE Liffe
Powernext SA
RTS Stock Exchange
Shanghai Futures Exchange
Singapore Exchange Limited
Singapore Mercantile Exchange
The London Metal Exchange
The South African Futures Exchange
Turquoise Global Holdings Limited

SPECIALIST COMMODITY HOUSES

Amalgamated Metal Trading Ltd
Cargill Plc
ED & F Man Commodity Advisers Limited
Engelhard International Limited
Glencore Commodities Ltd
Koch Metals Trading Ltd
Metdist Trading Limited
Mitsui Bussan Commodities Limited
Natixis Commodity Markets Limited
Noble Clean Fuels Limited
Phibro GMBH
RBS Sempra Metals
Sucden Financial Limited
Toyota Tsusho Metals Ltd
Triland Metals Ltd
Vitol SA

ENERGY COMPANIES

ALPIQ Holding AG
BP Oil International Limited
Centrica Energy Limited
ChevronTexaco
ConocoPhillips Limited
E.ON EnergyTrading SE
EDF Energy
EDF Trading Ltd
International Power plc
National Grid Electricity Transmission Plc
RWE Trading GMBH
Scottish Power Energy Trading Ltd
Shell International Trading & Shipping Co Ltd
SmartestEnergy Limited

PROFESSIONAL SERVICE COMPANIES

Actimize UK Ltd
Ashurst LLP
ATEO Ltd
Baker & McKenzie
Barlow Lyde & Gilbert
Berwin Leighton Paisner LLP
BDO Stoy Hayward
Clifford Chance
Clyde & Co
CMS Cameron McKenna
Complinet
Deloitte
Dewey & LeBoeuf LLP
FfastFill
Fidessa Plc
FOW Ltd
Freshfields Bruckhaus Deringer
Herbert Smith LLP
Hunton & Williams LLP
International Capital Market Association
ION Trading Group
JLT Risk Solutions Ltd
Katten Muchin Rosenman Cornish LLP
KPMG
Mpac Consultancy LLP
Norton Rose LLP
Options Industry Council
PA Consulting Group
Progress Software
R3D Systems Ltd
Reed Smith LLP
Rostron Parry Ltd
RTS Realtime Systems Ltd
Sidley Austin LLP
Simmons & Simmons
SJ Berwin & Company
SmartStream Techologies Ltd
SNR Denton UK LLP
Speechly Bircham LLP
Stellar Trading Systems
SunGard Futures Systems
Swiss Futures and Options Association
Traiana Inc
Travers Smith LLP
Trayport Limited

APPENDIX 2

COMMENTS ON THE DRAFT BILL

Comments on the Draft Bill

NB. The FOA anticipates that law firms and other legal experts will be commenting in detail on the draft legislation and the comments that follow are largely driven by general rather than legal / constitutional concerns over the drafting.

1. In view of the fact that the Financial Policy Committee will be advising the Bank of England on the Bank's Financial Stability Objective, the FOA questions the degree to which the Bank will itself be influenced by the various factors which the FCA is required to take into account, e.g. avoiding a significant adverse effect on the capacity of the financial sector to contribute to the growth of the UK economy (clause 9C(4)) or prejudicing the objectives of the FCA or the PRA (clause 9E(2)). If the Bank is not itself subject to similar constraints, it will be free to reject any FPC recommendations that take them into account. This seems to break the chain of accountability and the obligation to take into account proportionality and other statutory principles of good regulation.

2. The FOA notes the restriction on the scope of recommendations that may be made to the Bank by the FPC, namely, that they may not be made *"in relation to a particular financial institution"* (clause 9M(3)(a)).

   The FOA believes that this constraint will impair the ability of the FPC to fulfil its role in terms of identifying, monitoring and tacking action to remove or reduce systemic risks, or to protect the resilience of the UK financial system, including addressing systemic risks *"attributable to structural features of financial markets, or to the distribution of risk within the financial sector"* (clauses 9C(2) and (3)), in which certain CCPs have a critical part to play in the whole financial system.

3. Clause 1B(8) outlines the general functions of the FSA, which do not, but in the view of the FOA, should expressly cover the key regulatory functions of supervision and enforcement, i.e.:

   (i) it cannot be implied that they are covered because they are carried out pursuant to made rules under clause 1B(8)(a);

   (ii) the functions described largely in this sub-paragraph are more *"legislative functions"* than *"general functions"* (cf. para 1(2) of Schedule 1ZA on page 200 of the draft Bill); and

   (iii) supervision and enforcement are functions carried out pursuant to the arrangements described in para 9 of Schedule of 1ZA on page 202 of the draft Bill, but they are not the arrangements themselves.

4. Clauses 1I and 1K provide for the establishment of a Practitioner Panel and a Markets Practitioner Panel, but the FOA would emphasise that the preponderance of individuals appointed to each panel should be drawn from the specific interests represented by each panel, i.e. the majority of members of the Practitioner Panel should be drawn from authorised persons and those of the Markets Practitioner Panel should be drawn from market infrastructures.

It is noted that CCPs are not, but clearly should be, included in the list of eligible persons under clause 1K(5)) . and not left to the discretion of the FCA under clause 1K(6). It should make no difference that clearing houses will now be regulated by the Bank of England, insofar as there is a strong integration between the functions of clearing and execution.

5. Clause 1N provides that the Treasury may appoint an independent person to *"conduct a review of the economy, efficiency and effectiveness with which the FCA has used its resources in discharging its functions"*, but specifically excludes *"the merits of the FCA's general policy or principles in pursuing its strategic objective and its operational objectives"*. While it is not clear exactly what is covered by the words *"the merits of…"*, any review of the *"economy, efficiency and effectiveness"* of FCA's discharge of its functions cannot be comprehensively addressed, unless it includes how it has implemented the principles of good regulation in relation to the discharge of those functions.

   The FOA would urge HM Treasury therefore to consider revising (3) to read *"the review is not to be concerned with the merits of the FCA's general policy or principles in pursuing its strategic objective and its operational objectives, other than where and how they have taken into account in the discharge of any functions that are the subject of the review"*.

6. With regard to clause 2B, the FOA notes:

   - that the definition of *"PRA-regulated activities"* may be the subject of an Order made under s.22A of FSMA 2000 (see s.6 on page 91), but would emphasise the importance of Parliament being able to set the scope of the PRA and assumes, therefore, that any such Order will be the subject of affirmative Parliamentary oversight and believes that such Orders may be necessary to bring clarity to the scope of the PRA; and

   - that there is no equivalent definition of *"FSA-regulated activities"* and, while it is presumed that this is because it will cover all regulated activities, other than those to be covered by the PRA, believes that this should be stated expressly in the legislation.

7. Clause 2J(2) states that the PRA's arrangements for consulting PRA-authorised persons *"may"* include the use of such panels as the PRA thinks fit, but does not believe it is appropriate or desirable that the PRA should have absolute discretion in this matter. The FOA would emphasise the importance of establishing a Practitioner Panel on the same terms as the draft Bill requires the establishment of a Practitioner Panel to interface with the FCA for reasons set out in para 3.11 in this response). It continues to be unclear as to why a differentiated approach in this matter should be adopted as between the PRA and the FCA. The FOA believes that reasons for this kind of differentiation should be given, bearing in mind the circumstances surrounding the establishment of the existing Practitioner Panel, as mentioned in para 3.11 in this response.

8. With regard to clause 2L(3), the FOA would repeat its observations in para 5 above in relation to the FCA, and believes that it is entirely appropriate for the PRA‰ general policy or principles to be taken into account when determining whether or not it has discharged its functions with *"economy, efficiency and effectiveness"*.

9. The FOA believes strongly that clause 3B should include, as a regulatory principle, recognition of the need for firms to be competitive for reasons set out in paras 1.2 to 1.4, 3.4 and 4.13 in this response.

10. Clause 138J provides for PRA consultation in relation to the *"making"* of any rules by the FCA. Depending on how the word *"making+* is defined, it may not necessarily cover the disapplication or withdrawal of any rules, and while it can be assumed that most amendments would be achieved through newly *"made"* rules, it is possible that may not always be the case. For this reason, the FOA believes that the term should be extended to include *"making, amending or withdrawing"* any rules of the FCA.

11. It is noteworthy that the definition of *"market in the United Kingdom"* in clause 140A defines such issues as what is meant by its location and what is meant by references to a *"feature of the market in the United Kingdom for goods or services"* (which is construed as any structural or conduct issue). It does not actually define what is meant by a *"market"* which, in general terms, is an organised and regulated centre or network for the trading, in this context, of regulated financial instruments.

12. The FOA notes and welcomes the checks and balances outlined in clauses 312E to 312K on the power of the FCA to set and issue financial penalties on recognised bodies, but is concerned that no such checks and balances seems to apply in relation to regulated firms. For example, the obligation to publish a statement of sanctioning policy in draft form in order to allow representations to be made as regards any such proposed statement of policy is particularly welcome, but should surely be relevant to the sanctioning policy of regulated firms.

13. The FOA notes in clause 42 the listing of those %cases+under which the Bank of England must notify the Treasury of a possible need for public funds to cover financial institutions but makes no reference to CCPs, which are clearly going to become organisations of systemic importance and which, in the event of a significant default, may well require public funding to a comparable or even greater degree.

14. With regard to clause 17(6), the FOA would urge that, if the FCA decides not to adopt any recommendations of an investigator looking into a complaint against the FCA, it should be required, in addition to the matters set out in sub-para (6), to provide the investigator and the complainant with a statement of reasons as to why it has come to that decision.

15. Should the reference to *"the FCA's functions"* in clause 25(1), read *"the FCA's general functions"* or all its functions beyond those general functions, in which case have those other *"functions"* been clearly defined in order to determine the scope of statutory immunity?

16. In clauses 23 to 25, the FOA believes the observations made on the importance of maintaining the existing complaints scheme to cover complaints against the FCA, are

equally applicable to complaints against the PRA. Each scheme should reflect exactly the same level of independence, in terms of both appointment of investigators, functions and processes, as will apply to complaints against the FCA (and no reason for differentiated treatment appears to have been given).

The FOA also repeats the point made in para 14 above about the PRA providing a statement of reasons if it decides not to follow any of the recommendations of the investigator (in parallel with similar observations made as regards the situation pertaining to the FCA in the same circumstances).

17. With regard to clauses 29 to 35, the FOA repeats the points made in relation to the FCA as regards its approach and policy towards the issuance of penalties.

18. With regard to clause 166A, bearing in mind the potentially significant costs that may have to be borne by an authorised person, particularly in the case of a protracted investigation or in the context of small and medium sized enterprises, the FOA believes it is appropriate to have a reasonableness test that will have to be observed by the FCA in requiring a firm to appoint an external skilled person to gather information.