A New Approach to Financial Regulation

The ABI’s Response to HM Treasury’s consultation paper

Introduction

1. The ABI is the voice of insurance, representing the general insurance, 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. The ABI’s role is to:

   - Be the voice of the UK insurance industry, leading debate and speaking up for insurers.
   - Represent the UK insurance industry to government, regulators and policy makers in the UK, EU and internationally, driving effective public policy and regulation.
   - Advocate high standards of customer service within the industry and provide useful information to the public about insurance.
   - Promote the benefits of insurance to the government, regulators, policy makers and the public.

2. The ABI welcomes the opportunity to respond to ‘A new approach to financial regulation: judgement, focus and stability’.

Summary

3. The ABI is committed to working closely with Government and the regulatory authorities to make their proposals work. The main points we have in connection with the proposals are:

   - Co-operation between the regulatory authorities at all levels is essential in order to avoid overlaps and inefficiencies in the proposed regime.
   - Both PRA and CPMA should be required to take account of the competitiveness of the financial services industry.
   - The overall costs of regulation should be proportionate and the regulatory authorities should be required to use their resources efficiently.
   - The proposals do not sufficiently take account of the importance of the EU as the source of most legislation and rules relating to financial regulation.
Nor do the proposals make clear how the UK authorities will ensure a joined-up approach in their dealing with the European Supervisory Authorities.

- Prudential regulation of insurance must be given equality of status with that of banks within PRA to ensure that high-quality regulation continues.
- While the CPMA should seek positive outcomes for consumers, as a regulator it should adopt an evidence based approach taking account of the views of all stakeholders.
- There needs to be a strong markets division within CPMA with control over as many of the issues affecting the financial markets as possible. This will encourage coherence of supervision.
- The PRA must retain the FSMA safeguards and abide by the better regulation principles in order to ensure due process.
- The forthcoming changes to the legislative framework offer a timely opportunity to reassess the role and governance of the Financial Ombudsman Service (FOS), in particular how cases with wider implications are dealt with.

4. These points, and others, are explained in greater detail in our comments which are set out below and in the attached annex.

Overall comments

Introduction

5. The ABI believes in high quality regulation and we understand the drivers for regulatory change in financial services. We are, therefore, committed to making the Government’s proposed reforms work. However, we are extremely concerned at much of the detail in the consultation.

6. The major outcomes we would hope to see from a revised regulatory structure are:

- Improved financial stability;
- Consumers’ and investors’ needs being put at the centre of the new regulatory structure;
- A regulatory system that does not stand in the way of continued, positive innovation in the financial system;
- High standards of consultation and open working with the financial services industry;
• Close co-operation at all levels between all the regulatory bodies in the new structure; and

• In relation to insurance specific points:
  
  i. Insurers play a key role as long-term investors in the UK economy. This should not be stifled by inappropriate read across to insurers of new regulatory requirements put in place as a result of the banking crisis;

  ii. regulatory changes should not disrupt the UK’s competitive and world-leading insurance markets – competition ensures that consumers receive choice and good value from insurers; and

  iii. Effective regulation needs to reflect the risks and business models of different activities. It would be inappropriate for regulatory requirements designed for systemically important banks to be imposed on insurers.

  iv. Insurance regulation needs to be properly resourced and given equal status with banking, particularly within the PRA.

7. There is no ideal regulatory structure and we believe that the Government’s proposed ‘twin peaks’ model with separate prudential and conduct regulators, which has already been adopted in a number of countries, is a model which can work. Whatever structure is adopted the ABI is committed to working closely with Government and the regulatory authorities to make it work. However, in the nature of things most of our comments set out below are suggestions for improvements, or warnings about dangers to avoid, but these should all be taken in the spirit of constructive suggestions designed to ensure that we get the best regulatory structure possible.

   Overall

8. Inefficient Regulatory Structures - We believe that there is a potential for considerable inefficiencies, additional cost and overlapping jurisdictions to arise between the various bodies as a result of the complex mechanisms proposed to ensure co-ordination. We recognise that these arrangements are intended to ensure that the weaknesses identified in the Tripartite arrangements do not occur under the proposed new regime. However, as they stand we have a number of concerns with these proposals:

   • They set up bureaucratic solutions to avoid overlap (joint membership of Boards and formal liaison arrangements) while tolerating overlap at operational level (for example proposing that PRA and CPMA will operate separate regimes for authorisations and permissions). In practice efficient joint working will require the PRA and CPMA to work together at all levels, not just at that of the most senior management, so that the two regulators
can take an integrated approach to supervision of firms (for example by ensuring that firms are not required to implement multiple rule changes at the same time). Without it, firms could easily receive two conflicting or contradictory sets of instructions from the respective regulators.

- They appear to operate largely in a top-down manner with the FPC having an ability to direct the PRA and CPMA to undertake certain actions (and a requirement on CPMA to consult with PRA in certain situations) but little provision for FPC to take account of the views of the other bodies (or for the consumer and market implications of PRA decisions to be taken into account). We suggest that the objectives of each of the bodies should have regard for the work of the others. Otherwise there is a risk of the structure becoming fragmented, when the stated aim of the reforms is to tackle some of the disconnections that arose from the Tripartite regime.

We believe that a possible way to alleviate some of these concerns would be for certain functions, including authorisations and approvals, to be carried out jointly. We suggest that an appropriate model for undertaking such joint work might be for a joint ‘service organisation’ to undertake these roles which would report equally to both PRA and CPMA and would help ensure the necessary co-ordination between the regulatory bodies. Such a ‘service organisation’ could also undertake other joint administrative roles such as fee collection and approval for passporting firms. The aim should be to minimise administrative costs during and after the transition to a new regime.

9. Role of the EU - The proposals do not sufficiently recognise the influence of EU developments on UK regulatory rules and practice – in effect almost all the relevant requirements for both prudential and conduct of business regulation are now set at EU level. This will increase further given that the new EU supervisory authorities will set binding technical standards. In practice this will severely limit the discretion of the UK authorities and, in particular, is likely to limit the extent to which the PRA can operate its proposed ‘judgement’ based approach to regulation given the trend in Europe towards more detailed rules and consistency of approach across regulators, both in terms of the rules themselves and the supervision of those rules. We are also concerned that the proposals will result in a fragmentation of UK representation in Europe - the PRA will represent the UK in the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA), and CPMA will have this role for the European Securities and Markets Authority (ESMA). While this can work we would urge that consideration is given to practical engagement on how, for example, conduct of business matters in EIOPA will be dealt with. There will be a need for close liaison between the authorities to ensure that the correct UK representatives are involved in the work of the EU bodies.

10. Timing – The consultation paper proposes that the new regulatory structures will be in place by 2012. We understand the Government’s desire to make these changes quickly but it is a very challenging timetable and there must be considerable risks and difficulties in meeting it - revising the current Financial Services and Markets Act, especially the large amount of supporting secondary legislation, will be a
considerable task. We would be grateful for additional clarification of the timetable and stand ready to assist with this process.

11. *Shadow organisations* - We understand that the FSA and the Bank of England are already in the process of reorganising their internal structures to shadow the proposed new organisations. There are clearly benefits in the FSA and Bank seeking to move to the new structures in order to ensure a smooth transition to the new regime. For example, the arrangements should help to identify any teething issues that need to be resolved prior to introducing legislation. However, such reorganisations could pre-empt the Parliamentary legislative process in such a way that it would be difficult and expensive to undertake further changes in the event that Parliamentary scrutiny results in significant changes to the proposals. We suggest that while the FSA and the Bank should begin planning for the new structures that they hold off substantive reorganisations at least until after the Government's legislation has received a second reading in the House of Commons. Once finalised, the arrangements should be implemented quickly, so as not to undermine 'business as usual' work.

12. *Distraction from ongoing work* – There are currently a substantial number of major regulatory developments underway (such as Solvency II and implementation of the Retail Distribution Review) and we are concerned that undertaking a major reorganisation of the regulatory structure at the same time will distract the authorities from focusing on implementation of these developments. In particular we are concerned that the Treasury and FSA may not ensure that the best outcome is achieved for the UK in the negotiations on how to implement Solvency II. The FSA and the Government should set up specialist teams to ensure that the new structures can be implemented without distracting from ongoing work. At the very least, there should be a clear process to monitor the implementation of the most sensitive projects being inherited from the FSA.

Financial Stability

13. The ABI supports the Government's intention to create a Financial Policy Committee in the Bank of England to be responsible for financial stability and macro-prudential regulation. The FPC may have to take decisions, such as limiting the amount of credit available, which could have significant political and societal implications. We are concerned that the proposed structure has insufficient political oversight (with the Treasury being limited to an observer role) and that it may have insufficient non-central banking expertise (as it will be dominated by Bank of England executives).

PRA

14. We are extremely concerned that the Government is considering removing the safeguards, such as requirements to consult and mechanisms to appeal regulatory decisions, currently within FSMA and we believe that these should be retained for the PRA. The consultation paper provides no justification or explanation as to why the Government believes that such safeguards might not be required – particularly
given that it is intended to maintain the safeguards in respect of the CPMA. These safeguards are needed to ensure that the regulatory authorities have undertaken due process in setting rules and making regulatory decisions and to ensure that the industry and other stakeholders (including consumers) are able to contribute to this process. There is also a need for a formal process through a complaints mechanism and the Upper Tribunal for firms to complain about failures in the way the regulator has acted or to appeal regulatory decisions which they believe are incorrect. The move to a new regulatory structure based in the Bank should not represent a retreat from the relatively open and consultative approach of the FSA.

15. The Government’s consultation paper proposes that the PRA will not have a duty to take account of the competitiveness of the industry in setting its rules. We do not agree with this and strongly support the retention of the need for the PRA to take account of the competitiveness of the industry in undertaking its regulatory responsibilities. The UK financial services industry is a world leader and this provides substantial benefits to the wider economy through creating many skilled jobs, its impact on the balance of payments and on tax receipts. A strong regulatory environment is a competitive advantage for UK firms but it is essential that regulation does not damage the UK’s attraction as a centre for financial services or add costs for consumers.

16. The emphasis in the consultation paper is, understandably, on the close links between the PRA and the senior management of the Bank of England but while this will clearly be beneficial to the supervision of banks it is unclear that this will provide commensurate benefits for insurance regulation. We believe that to ensure high quality insurance supervision it is essential for this to have equal status within the PRA as banking supervision. We think that this is best done by having a head of insurance supervision on a par with the head of banking supervision, ensuring that a number of the non-executive directors of PRA are chosen for their insurance expertise and sufficient training for insurance supervisors to maintain and improve their professional skills and provide a career path for specialist insurance supervisors. In addition the PRA must ensure that it employs a sufficient number of actuaries and experts on insurance risk in its policy teams.

17. Regulation of firms should be proportionate to the risks they pose to regulatory objectives. We believe that insurers, due to the nature of their business, do not normally give rise to systemic risk and this should be taken into account in how the PRA regulates insurance business. It would be inappropriate for regulatory requirements designed for systemically important banks to be imposed on insurers.

18. It is unclear to us how group supervision arrangements will operate in the new structure. Many insurers have significant fund management divisions and under the proposals these will be prudentially regulated by CPMA rather than PRA. We agree that the CPMA should be responsible for the prudential supervision of fund managers at entity level but to avoid potentially unclear and inconsistent requirements arising at group level we suggest that that the PRA should be the lead supervisor for prudential supervision of insurance led groups. Similarly where an
asset management group has an ancillary insurance business lead supervision should be with CPMA.

**CPMA**

19. The Government states that the CPMA should act as a ‘consumer champion’. We agree the CMPA should have a clear primary objective which focuses on promoting and protecting the interests of consumers. However, the legislation needs to be framed to reflect the distinction between advocacy and independent regulation. The CPMA should take an evidence based approach to policy-making and supervision taking account of the views of all stakeholders. Whilst the CPMA should strive to achieve good consumer outcomes, it should also recognise that there must be a proper balance between consumer protection and consumer responsibility. The CPMA should expect firms to provide consumers with information that allows them to make informed decisions. But it must also accept that consumers have the freedom to choose and will not make the right decision on every occasion.

20. Currently the Government proposes that the CPMA will not have a duty to take account of the competitiveness of the industry or of the desirability of facilitating innovation and competition in setting its rules. Although CPMA will need to identify and address any competition weaknesses in financial services markets, it should understand the benefits that competition can deliver to consumers and seek where possible to facilitate effective competition. We note that other key consumer regulators in the UK – such as Ofgem and the Legal Services Board – have objectives to promote and protect the interests of consumers where appropriate through promoting effective competition. This makes sense – competition helps ensure prices are low and products/services are of a good quality. So we propose that CPMA should be subject to a similar primary objective. The CPMA should also be required to have regard to the benefits of UK competitiveness and innovation as the FSA currently is.

The Government has indicated it will examine how consumer protection is enshrined in FSMA and update or strengthen the regime. We would welcome an open debate on the purpose and objectives of conduct regulation to ensure the CPMA is clear about the outcomes it will be measured against. It is important to recognise that consumers have an interest in not only being ‘protected’ from sub-optimal products but also in accessing products that meet their financial needs. For example, we propose CPMA should be required to take account of broader Government objectives such as promotion of saving and preventing excessive household debt. This could be achieved by introducing a legislative option for Government to issue guidance to CPMA on these matters.

21. An important issue which is not addressed in the consultation is the extent to which product regulation will be a tool at the disposal of the CPMA. The FSA has
traditionally been sceptical about the merits of product regulation, but more recently it has indicated that it may form part of its new Retail Conduct Strategy. We would not support new requirements on providers to get approval from the regulator before launching products as this would unduly limit consumer choice and competition. In addition, experience in recent years with stakeholder products shows that product regulation is unlikely to deliver good customer outcomes unless it is accompanied by a streamlined sales regime. But we suggest it is important for Government to lead a debate on this issue and set out a clear strategic framework for CPMA.

22. The forthcoming changes to the legislative framework offer a timely opportunity to reassess the role and governance of the Financial Ombudsman Service (FOS). We support the core function of FOS – to provide an independent, informal and accessible service for resolving individual customer complaints. So we favour retention of FOS’s clear mission statement in FSMA – “a scheme in which certain disputes may be resolved quickly and with minimum formality by an independent person”.

23. However, it should be recognised that the complaint profile of the FOS has changed markedly since its inception. Over one half of all complaints referred to the FOS have related to just six topics. Problems have sometimes arisen where FOS decisions have much wider implications for the industry because they impact upon large volumes of similar cases. Such cases require consultation with all the key stakeholders and analysis of the costs and benefits of a particular approach to all complaints of that type. This form of quasi-regulatory analysis cannot be satisfactorily conducted by FOS as a non-regulator.

24. We propose the CPMA would be better placed to conduct such an assessment and to give binding guidance to the FOS on its approach to similar cases. There are a number of different approaches to defining the precise process for handling of such cases (for example they might be referred to the Financial Services and Markets Tribunal). But at this stage we recommend the Government should review the handling of complaints with wider-implications and include the issue within its reform of the legislative framework. It should also take this opportunity to examine the high-level governance of the FOS to assess if it is in line with best practice for other similar statutory bodies.

25. Although the consultation paper refers to CPMA as a single focused regulator for retail conduct issues, we note that other regulators will continue to have important roles in regulating retail financial services markets. To that end, we welcome the prospect of a consultation later in the autumn on transferring the Office of Fair Trading’s (OFT) regulatory responsibilities for consumer credit to the CPMA. However, we propose the Government should go further and seek views on the merits of transferring the OFT’s competition and consumer protection powers over financials service markets to the CPMA. In recent years the OFT and the FSA have conducted overlapping but not fully coordinated investigations into the same financial services market – such as payment protection insurance. An integrated
consumer regulator might be better placed to take a coherent approach to analysing the market and identifying appropriate regulatory interventions. The recently announced plan to consult on reform of competition and consumer bodies in the New Year provides a vehicle to seek views about the implications for financial services regulation.

26. Meanwhile, The Pensions Regulator (TPR) is another body with a remit to protect the interests of pension scheme members (in their case occupational pensions). Insurers sometimes find that the responsibilities and activities of TPR and FSA overlap. That said, TPR has a quite distinctive set of relationships with employers and will have an important role in the introduction of auto-enrolment in 2012. So we suggest the Government should also explore the advantages and disadvantages of integrating TPR within CPMA and consult with the relevant stakeholders.

Market Regulation

27. We welcome the Government’s recognition in the consultation of the economic and strategic significance of the whole sale financial markets to the UK. Unfortunately the Government's proposals for the regulatory structure divide responsibility for the financial markets unworkably between the Bank, PRA, CPMA and FRC. This division of responsibility creates a significant risk of regulatory fragmentation and incoherence, representing a serious threat to the competitiveness of the UK’s wholesale financial market, and to the ability of the financial markets to finance the economic recovery.

28. To make the best of the structure under consideration, two things need to be done:

(i) The CPMA needs to have the full authority to regulate the wholesale markets, with control over as many of the issues affecting the financial markets as possible. This will encourage coherence of supervision, and ensure that the UK’s voice is respected in ESMA. CPMA should be responsible for wholesale market conduct, but also for the following areas:

- The market regulation of financial institutions dealing in investments as principal;
- The regulation of settlement systems and central counterparties bodies;
- The UK Listing Authority; and
- Integral supervision of fund managers with small insurance arms.

(ii) The statutory objectives and senior management structure of the CPMA must reflect the significance to the UK economy of wholesale market regulation:

- There are significant risks in brigading together regulation of the wholesale markets with retail regulation. The White Paper rightly recognises the different nature of wholesale markets. However, the underlying regulatory issues are also very different. Wholesale markets are complex, involving several professional parties, very different from the straightforward consumer/supplier relationship usually found in the
retail market. Market efficiency is the key issue, rather than protection of particular parties in the markets.

- There is a risk that the CPMA will develop a culture which is dominated by consumer protection issues, and that this will affect the markets division where the issues are very different. An operationally distinct division within CPMA is not enough. The different approach to the wholesale markets needs to be reflected robustly in the statutory objectives of the CPMA, and in the management structure of the CPMA – which we would suggest should reflect these differences by, for example, having separate management structures for the two activities including in areas such as enforcement.

Financial Crime

29. Financial crime occurs in many different guises, including insider dealing, boiler room scams, money laundering, bribery and fraud. It impacts upon individuals, financial institutions and society at large, whether that be through imposing unnecessary costs on customers, conferring an unfair advantage on a firm, or facilitating serious organised crime.

30. While the consultation makes reference to possible wider reforms to the approach to tackling economic crime, no detail is provided about what these wider reforms might look like. Specific mention is made of the FSA's existing prosecution powers, but of course financial crime regulation is about more than bringing prosecutions; rather there is a broad objective to reduce the extent to which it is possible for a financial business to be used for a purpose connected with financial crime.

31. As we currently understand the Government’s proposals, there is potential for financial crime regulation to be highly fragmented, with market integrity activity (e.g. boiler room scams, insider dealing) being regulated by the CPMA while financial crime affecting an insurer’s profit and loss account (e.g. fraud) would be regulated by the PRA. Further, with the CPMA responsible for the prudential regulation of brokers, there may be an argument for insurance fraud affecting brokers to be regulated by the CPMA while insurance fraud affecting insurers is regulated by the PRA. It is important that such fragmentation does not lead to inefficiencies and ineffectiveness to the detriment of those that the regulation is designed to protect.
Questions for Consultation

The Bank of England and Financial Policy Committee (FPC)

1 Should the FPC have a single, clear, unconstrained objective relating to financial stability and its macro-prudential role, or should its objective be supplemented with secondary factors?

2 If you support the idea of secondary factors, what types of factors should be applied to the FPC?

We believe that the FPC’s central objective relating to financial stability needs to be supplemented with secondary factors. This is necessary to ensure that the FPC properly takes account of the impact of its decisions both in the wider economy and in relation to the regulated entities that might be affected by macro-prudential judgements.

The factors identified in paragraph 2.28 of the consultation appear to be the appropriate ones to be taken into account. In particular (and given the lack of political oversight over the work of the FPC) there is a need to take account of the possible societal impacts of FPC decisions which may, for example, reduce the amount of credit available to some groups of citizens.

3 How should these factors be formulated in legislation – for example, as a list of ‘have regards’ as is currently the case in the Financial Services and Markets Act 2000 (FSMA), or as a set of secondary statutory objectives which the FPC must balance?

There is a danger that formulating these factors as secondary objectives could constrain the ability of the FPC to carry out its main objective. However, simply formulating these factors a list of ‘have regards’ might not result in sufficient weight being placed on these issues.

We believe, therefore, that an appropriate approach would be for the FPC to have a positive legal duty to show that its decisions are consistent with the objectives of the PRA and CPMA (and with wider Government policy positions where appropriate) or to explain why any decision inconsistent with these objectives is justified.

Prudential regulation authority (PRA)

4 The Government welcomes respondents’ views on:
   • whether the PRA should have regard to the primary objectives of the CPMA and FPC;
   • whether some or all of the principles for good regulation currently set out in section 2 of FSMA, particularly those relating to good regulatory practice, should be retained for the PRA;
• whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained; and
• whether there are any additional broader public interest considerations to which the PRA should have regard.

We agree that the PRA should have regard to the primary objectives of both the FPC and CPMA. Given that the Government intends that the FPC will have a power to direct the PRA to take certain actions it therefore seems clear that there will be a need for the PRA to have regard to the FPC’s objectives so as to enable it to operate in accordance with the FPC’s policy intent. In the case of the CPMA it is clear that actions taken by the PRA to improve prudential standards could lead to consumer detriment (if for example additional capital requirements resulted in a reduction in returns on certain investments) and it is, therefore, appropriate for the PRA to take account of this in reaching its decisions.

We believe that it is essential that the PRA continues to be bound by the principles of good regulation. Indeed we find it difficult to understand why the consultation paper even raises the possibility that it might not be appropriate for the PRA to have regard to principles such as using its resources in the most efficient and economic way, taking account of the responsibilities of those managing regulated firms and ensuring that any regulatory burden imposed is proportionate to the benefits expected. Adherence to such principles should be expected from any public body – successive governments have emphasised the importance of regulators acting in accordance with the principles of good regulation.

The UK financial services industry is a world leader. A strong regulatory environment can be a source of competitive advantage but it is essential that regulation does not damage the UK’s attraction as a centre for financial services or add to the costs for consumers. We, therefore, strongly support the retention of the need for the PRA to take account of the competitiveness of the industry in undertaking its regulatory responsibilities.

5 Is the model proposed in paragraph 3.16 – with each authority responsible for all decisions within their remit subject to financial stability considerations – appropriate, or would an integrated model (for example, giving one authority responsibility for authorisation and removal of permissions) be preferable?

We are concerned that the proposals as drafted could result in considerable overlap and duplication between the CPMA and PRA in carrying out their functions. For example the situation described in paragraph 3.16 of the PRA and CPMA separately undertaking approval of persons applying to hold significant influence functions appears to be a case in point – it simply does not make sense for the same individual to be subject to two separate approval processes.

The very fact that the two regulators espouse different approaches could itself give rise to inconsistency in decision making for some aspects; whereby appointments and approvals sanctioned under the PRA’s judgement based approach could be at variance with the CPMA’s pre-emptive one. Furthermore, dual responsibilities in relation to approved persons could make an already lengthy process, unacceptably longer.
We, therefore, believe that it would make sense for certain functions including authorisations and approvals to be carried out jointly. We believe that the most appropriate model for undertaking such joint work might be for a joint ‘service organisation’ to undertake these roles which would report equally to both PRA and CPMA. Such a ‘service organisation’ could also undertake other joint administrative roles such as the fee collection and approval of passroting applications (see also our response to question 13).

6 Is the approach outlined in paragraph 3.17 to 3.23 for transfer of regulatory functions and rule making sufficient to enable the PRA to take a more risk-based, judgement-focused approach to supervision?

The ABI welcomes the proposal to move to a more risk-based approach to regulation. However, we believe that a more judgementally focused approach will need to be carefully thought through to ensure that there is consistency in decision making and that proper due process and legal certainty is achieved. It would not be acceptable for a more judgemental approach to result in inconsistent regulation between firms or the imposition of short notice and retrospective changes in regulatory requirements.

We note the intention in paragraph 3.24 for the PRA to reduce the current FSA handbook. This would clearly be welcome. However, any such effort to make substantive reductions will need to take account of the fact that most prudential requirements on firms derive from EU directives and it will remain a requirement on the PRA to show that it has properly implemented the directives and is regulating in accordance with their requirements. It should also be noted that under the new European system of regulation the EU supervisory authorities will issue binding standards which will have to be adopted by national regulators.

This means that in practice most prudential regulatory requirements will be at the EU level and the ability of the PRA to adopt a different approach will be severely constrained. We are not convinced, on the evidence of the consultation paper, that the primacy of Europe in this area has been fully recognised, or the importance of the UK authorities engaging fully at the EU level.

We agree with the proposed key functions of the PRA as set out in paragraph 3.20 of the paper.

We can see the attractions of using FSMA as the basis for the new authorities’ powers and doing so is the method most likely to reduce the legislative timetable needed. However, it is not clear to us that FSMA will lend itself to being readily split between prudential and conduct issues. It will also be essential to recast the large body of secondary legislation which supports the current FSMA framework. The Government will need to bear this in mind in assessing a realistic timetable for moving to the new structures.

7 Are safeguards on the PRA’s rule-making function required?

8 If safeguards are required, how should the current FSMA safeguards be streamlined?
It is essential that the full range of safeguards currently within FSMA should be retained for the PRA. The consultation paper provides no justification or explanation as to why the Government is considering whether the existing statutory processes around the rule-making process are required in respect of the PRA – particularly given, as paragraph 4.36 makes clear, that it is intended to maintain the safeguards in respect of the CPMA.

These safeguards are needed to ensure that the regulatory authorities have undertaken due process in setting rules and making regulatory decisions and to ensure that the industry and other stakeholders (including consumers) are able to contribute to this process. There is also a need for a formal process through a complaints mechanism and the Upper Tribunal for firms to complain about failures in the way the regulator has acted or to appeal regulatory decisions which they believe are incorrect.

9 The Government welcomes views on the measures proposed in paragraphs 3.28 to 3.41, which are designed to ensure that the operation of the PRA is transparent, operationally independent and accountable.

In general the proposals in paragraphs 3.28 to 3.41 would appear to ensure that the PRA is transparent, operationally independent and accountable.

However, we are concerned about the lack of detail about the proposed internal organisation of PRA. There is no mention of the way that insurance regulation will be structured to ensure that this is undertaken and managed by suitably qualified staff. The emphasis in the consultation paper is, understandably, on the close links between the PRA and the senior management of the Bank of England but while this will clearly be beneficial to the supervision of banks it is unclear that this will provide commensurate benefits for insurance regulation.

We believe that to ensure high quality insurance supervision that it is essential for this to have equal status within the PRA as banking supervision. This might best be done by having a head of insurance supervision on a par with the head of banking supervision, ensuring that a number of the non-executive directors of PRA are chosen for their insurance expertise and sufficient training for insurance supervisors to maintain and improve their professional skills and provide a career path for specialist insurance supervisors. In addition the PRA must ensure that it employs a sufficient number of actuaries and experts on insurance risk in its policy teams.

9 The Government welcomes views on:
• whether the CPMA should have regard to the stability of firms and the financial system as a whole, by reference to the primary objectives of the PRA and FPC;
• whether some or all of the principles for good regulation currently set out in section 2 of FSMA should be retained for the CPMA, and if so, which;
• whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained; and
• whether there are any additional broader public interest considerations to which the CPMA should have regard.

Consumer protection and markets authority (CPMA)

10 The Government welcomes respondents’ views on:
• whether the CPMA should have regard to the stability of firms and the financial system as a whole, by reference to the primary objectives of the PRA and FPC;
• whether some or all of the principles for good regulation currently set out in section 2 of FSMA should be retained for the CPMA, and if so, which;
• whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained; and
• whether there are any additional broader public interest considerations to which the CPMA should have regard.
Shaping the statutory objectives and duties for the CPMA is important because it will determine the mission and culture of the new regulator. The Government should draw on best practice, both from financial services regulators abroad and other consumer regulators in the UK.

The CPMA should have clear primary objectives which focus on promoting and protecting the interests of consumers, and on ensuring the integrity of the financial markets (we deal with this issue in greater detail in the answer to question 15). However, we are concerned by the absence of reference to ‘competition’ in the Government’s proposal. Although CPMA will need to identify and address any competition weaknesses in financial services markets, it should understand the benefits that competition can deliver to consumers and seek where possible to facilitate effective competition. We note that other key consumer regulators in the UK – such as Ofgem and the Legal Services Board – have objectives to promote and protect the interests of consumers where appropriate through promoting effective competition. So we propose that CPMA should be subject to a similar primary objective. We agree that the CPMA’s role in ‘ensuring confidence’ should be referenced, as should ‘market integrity’, given the CPMA’s responsibility for wholesale markets.

There are further lessons to be learned from the statutory frameworks of other UK regulators. For example, OFCOM must have regard to the desirability of promoting and facilitating the development and use of effective forms of self-regulation. While self-regulation is not appropriate in all circumstances, the OFT and others have recognised that it can offer some advantages over statutory regulation, notably its flexibility and responsiveness in the face of change. The legislation should encourage the CPMA to make use of this option where it can deliver good outcomes for consumers.

We also propose that CPMA should be required to take a risk-based approach to all aspects of its regulation. While we understand the rationale for the FSA’s adoption of an ‘early intervention’ strategy to address conduct risks before they are fully crystallised, regulators should continually analyse markets and focus their activities on areas where there is greatest risk of consumer detriment. For example, experience suggests that consumer risks are more likely to arise in the context of sales of retail investment products than the motor insurance market.

Below we respond to each of the specific issues raised in Question 10. The ABI believes:

- CPMA should have regard to the stability of firms and the financial system as a whole, by reference to the primary objectives of the PRA and FPC. The success of the new regulatory framework will rely on proper coordination between the activities of the different regulators. CPMA should not pursue actions that pose a significant risk to financial stability, so we strongly support the proposed requirement for the CPMA to consult with the PRA before it takes any decision that could present a risk to financial stability.
- All of the principles of good regulation that apply to the FSA through Section 2 of FSMA should be retained for the CPMA. Most of the regulators in the UK are subject to statutory requirements to take account of good regulatory principles. The CPMA will have extensive regulatory powers over a key sector of the UK
economy, so it is in the interests of UK consumers and businesses alike for it to exercise those powers in line with good regulatory practice. We are surprised, for example, that the Government would question the need to encourage the CPMA to use its resources in an efficient and economic way.

- We consider it particularly important to require CPMA to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector. Innovation in the market place can deliver considerable benefits to consumers. For example, the growth of comparison websites is a technological and market innovation which has increased competition in financial services markets and made it easier for consumers to compare alternative options. So we are concerned at the suggestion that the CPMA should not be required to have regard to the benefits that innovation can deliver. Similarly CPMA, with its extensive powers of intervention into UK retail and wholesale markets, needs to be alert to the impact it is having on competitiveness. The UK financial services sector is of huge importance to the UK economy and the CPMA should give weight to the implications in terms of jobs, growth and taxation and so on of different regulatory actions.

- We consider that one of the weaknesses of UK financial services regulation in recent years has been an imbalance whereby regulation of credit products has been considerably lighter than regulation of savings/investment products. This was despite the Government having a broader public policy objective of promoting saving, particularly for retirement. So we think there are lessons to learn from the legislative requirements on utility regulators Ofgem and Ofwat. They are required to have regard to guidance issued by Government in relation to their contribution towards the attainment of social and environmental policies. In a similar way, we propose HMT should have powers to provide guidance to CPMA about its contribution to social/economic goals such as promotion of saving and preventing excessive household debt.

11 Are the accountability mechanisms proposed for the CPMA appropriate and sufficient for its role as an independent conduct regulator?

We support the proposed accountability mechanisms, and in particular we welcome the proposal to make CPMA subject to audit by the National Audit Office. The requirements on FSA to conduct cost-benefit analysis prior to introducing new rules and the public consultation requirements are an important part of its accountability, so we welcome the proposal to make CPMA subject to the same requirements. Further, we believe there would be a more holistic analysis of the implications of policy making if CBAs were obliged to include reference to related regulatory initiatives (for example, from HM Treasury) and clearly set out any implications for the PRA. While the production of business plans and reports on an annual basis is important, we believe the CPMA should take a more strategic approach than the FSA and provide more clarity about its strategic priorities, market reviews and general business planning over a three to five year period. We also suggest the CPMA should be required to conduct ex post impact assessments to determine whether its regulatory interventions have achieved the stated intentions and learn lessons for the future.

12 The Government welcomes views on the role and membership of the three proposed statutory panels for the CPMA.
We agree the proposed statutory panels representing consumers, practitioners and small business practitioners could play an important role in scrutinising the regulatory activities of CPMA. However, it is important to recognise that the activities of the PRA will have a major impact upon practitioners (and indeed consumers) so we would expect the statutory framework of the panels to reflect this. We also suggest a clearer case needs to be made as to why two different panels are needed to represent practitioners.

The membership of the practitioner panels should represent all parts of the financial services sector, as the interests of insurers can be quite different from investment banks for example. In principle, currently the Panels have an opportunity to discuss with the FSA plans for new regulatory policies before the proposals are made public. In this regard the Panels provide an important sounding board for the FSA from the full industry point of view, at a different level to the more detailed debate with industry on the impact of changes at sector level. To be effective, each of the panels needs sufficient resource to conduct research and analysis, and to develop its own independent policy-making function. We support the intention of the Financial Services Practitioner Panel to widen its membership so that it has access to a greater pool of executive resource to engage with regulators at any given time. It is equally important that the Panels strengthen their links – both between the panels themselves and with industry – particularly through early engagement with trade associations. A dedicated section within the annual reports of the regulators would help to raise the profile of the Panels. In addition, the senior management of both CPMA and PRA should be required to take due account of recommendations and input from the panels, and make clear their reasoning when deciding to take a different course.

13 The Government welcomes views on the proposed funding arrangements, in particular, the proposal that the CPMA will be the fee- and levy-collecting body for all regulatory authorities and associated bodies.

We agree that a single body should be responsible for collecting the fees and levies for all regulatory authorities and associated bodies. As set out in our response to question 5 above we believe that this might best be undertaken by a joint service organisation which carries out a number of administrative functions for both the PRA and the CPMA.

We urge the Government to use this opportunity to consult with stakeholders about the statutory framework for the associated bodies. For example, as outlined above, we believe the time is right to review the legislative requirements in relation to the Financial Ombudsman Service (FOS).

The ABI supported the establishment of the Consumer Financial Education Body (CFEB) and we agree that it should be operationally independent of the CPMA. However, while we accept that it is appropriate to wait for a few years before conducting a full review of CFEB’s operating model, backstop accountability to CPMA on budget and plans is important and we will be seeking more clarity regarding the consumer outcomes that CFEB is expected to achieve.
14 The Government welcomes views on the proposed alternative options for operating models for the FSCS.

We believe that it makes most sense for the FSCS to continue as a unified body but without the current cross-subsidy arrangements. Given the FSCS’s responsibilities it will need to work closely with both PRA and CPMA.

The ABI remains strongly opposed to the general pool arrangements introduced in 2007 which provides for cross-subsidy between different sectors. We do not believe that it is appropriate for firms (and ultimately their customers) in other sectors to become responsible for failures elsewhere given the major differences between the business models and risk profiles of each sector.

We, therefore, favour the retention of the FSCS in its current form - although this is dependent upon the outcome of the current FSA review of the FSCS and the likelihood that there will be an EU directive on insurance guarantee schemes in the next few years - but with the removal of the general pool arrangements. FSCS should remain operationally independent of both the PRA and the CPMA.

Markets and infrastructure

15 The Government welcomes views on the proposed division of responsibilities for markets and infrastructure regulation.

We welcome the Government’s recognition of the economic and strategic significance of the wholesale financial markets to the UK. Unfortunately the Government’s proposals for regulatory structure divide responsibility for the financial markets unworkably between the Bank, PRA, CPMA and FRC. This division of responsibility creates a significant risk of regulatory fragmentation and incoherence, representing a serious threat to the competitiveness of the UK’s wholesale financial market, and to the ability of the financial markets to finance the economic recovery.

A more appropriate structure would have been to establish a Markets Authority under the oversight of the Bank, on a level with the CPMA and the PRA. However, if the preferred approach is to maintain the main planks of the White Paper structure, then to make the best of the structure under consideration, two things need to be done:

(i) Regulation of the financial markets must as far as possible be brought together in the CPMA, responsible for wholesale market conduct, but also for:

- The market regulation of financial institutions dealing in investments as principal (see para 3.15 on the PRA). Under the proposals in the White Paper, the prudential regulation of investment banks and other market-makers and traders in investments would fall to the PRA, while the prudential regulation of asset managers and other participants in the financial markets, and the regulation of conduct in those markets would fall to the CPMA. In these circumstances, maintaining a consistent approach to prudential regulation will represent a serious operational
challenge. Much greater clarity is needed over the articulation of decision-taking that affects financial institutions dealing in investments as principal, and the wider impact of those decision in the markets. Further, in view of the explicitly superior status in the White Paper of the PRA to the CPMA, great care will be needed to ensure that investment banks’ de facto regulatory capture becomes institutionalised. It would be greatly preferable if prudential regulation were focused on the end users of the financial markets – investors and issuers;

- The regulation of settlement systems and central counterparties bodies (see below Question 16);
- The UK Listing Authority (see below Question 17)
- Integral supervision of fund managers with ancillary insurance arms.

(ii) The statutory objectives and senior management structure of the CPMA must reflect the significance to the UK economy of wholesale market regulation:

- There are significant risks in brigading together regulation of the wholesale markets with retail regulation. The White Paper rightly recognises the different nature of wholesale markets. However, the underlying regulatory issues are also very different. Wholesale markets are complex, involving several professional parties, very different from the straightforward consumer/supplier relationship usually found in the retail market. Market efficiency is the key issue, rather than protection of particular parties in the markets.
- There is a risk that the CPMA will take on a consumer protection attitude, and that this will affect the markets division. An operationally distinct division within CPMA is not enough. The different approach to the wholesale markets needs to be reflected robustly in the statutory objectives of the CPMA, and in the management structure of the CPMA by appointing one of the top two posts at the CPMA explicitly as the financial markets champion. A structurally distinct approach will be needed right down the CPMA, so that market issues are considered separately from retail issues, as opposed to an integrated structure in which consideration of all conduct or enforcement issues is considered inappropriately in one place, regardless of the different approaches needed.

We welcome the Governments’ recognition of the key role of the British regulatory authorities in exercising influence in the new EU authorities. The new binding standards-making power to be handed to the new EU authorities will change irrevocably the regulatory role of the British regulators. In future, negotiating in Europe will have a much greater impact on the market than writing British regulations. The structure and skills of the UK authorities need to reflect that. It should also be a priority for the British regulators to second good staff to the EU authorities.

16 The Government welcomes views on the possible rationalisation of the FSMA regimes for regulating exchanges, trading platforms and clearing houses.

There is a clear operational link between the regulation of market infrastructure and the regulation of market conduct. We see no logic in the proposal for the Bank to
oversee in isolation CCPs and settlement systems. This will lead to regulatory confusion, with institutions central to the orderly functioning of the financial markets regulated separately from the markets themselves. The PRA should keep a close eye on the balance sheet of CCPs, but all other matters should fall to the CPMA.

17 The Government would welcome views on whether the UKLA should be merged with the FRC, as a first step towards creating a companies regulator under BIS.

The work of the UKLA is important to our members as institutional investors because its work on disclosure and transparency underpins both the quality and the integrity of the investment market. This is relevant at the point of securities’ initial admission to listing, and to the continuing obligations of issuers - wherever those issuers are incorporated - choosing to access the UK’s capital markets. High standards in these respects are critical to the long-term interests of the savers and pensioners on whose behalf ABI members invest.

We take the view that the CPMA is the right location for the UKLA, for the following reasons:

- These additional responsibilities would pose a risk to the focus of the FRC’s work on corporate governance
- Moving the UKLA to the FRC would further fragment the regulation of the wholesale financial markets. We are looking to pull together in a markets division of the CPMA as many as possible of the regulatory functions relating to the capital markets
- The separation of regulation of the primary markets in the UKLA from regulation of the secondary markets in the CPMA would be particularly awkward to co-ordinate on a day-to-day basis
- Only 6% of the listed bodies overseen by the UKLA are UK corporates
- The deliberative, Board-based decision-making of the FRC is very different from the real time decisions on, for example, market suspension required by the UKLA
- The FRC will not be a member of the EU authority ESMA that will in future set the rules in this area – that will be CPMA, - and could not therefore attend the top level ESMA decision-taking meetings.

However, in keeping with the spirit of the Business Secretary’s forthcoming review of corporate governance and economic short-termism, we believe that the UKLA should be more visible when operating within the CPMA than it has in the FSA. The UKLA should also continue the progress made in recent years to ensure that appropriate quality of admission to listing criteria, and standards of investor protection, are maintained.

18 The Government would also welcome views on whether there are other aspects of financial market regulation which could be made more effective by being moved into the proposed new companies regulator.

There is little detail in the White Paper on the purpose and tasks of such a regulator, and in the absence of this detail we find it difficult to comment. We would oppose any attempt to alter the independent status of the Takeover Panel. A link with
Companies House would be inappropriate. Investors have consistently opposed the creation of a body such as the SEC in this jurisdiction. On the other hand, we value the work of the FRC on corporate governance, and would not wish to see this called into question by efforts to find a larger home for the FRC. We applaud the Government’s desire to reduce the number of quangos, but this should not be an overriding objective when the existing arrangements work.

Crisis management

19 Do you have any overall comments on the arrangements for crisis management?

The proposed arrangements appear to be satisfactory in principle. However, the paper gives little detail about how these would operate in practice – paragraph 6.7 makes clear that the Treasury and Bank need to develop contingency plan. We recommend, therefore, that the Government and Bank consult further on the proposed arrangements when these have been fully developed.

20 What further powers of heightened supervision should be made available to the PRA and the CPMA, and in particular would there be advantages to mandatory intervention, as described in paragraph 6.17?

We believe that the Government should look at the need for these new powers in the context of different sectors. For example, we remain unconvinced of the need for additional resolution powers in respect of insurers given that insurance failures are spread over a long period of time and can, therefore, be dealt with adequately by existing insolvency requirements. We also believe that in the case of insurers the supervisory authorities can already intervene long before threshold conditions are breached (the third bullet of paragraph 6.17).

In respect of the proposals in paragraph 6.17 we agree that there is merit in making clearer the scope of the OiVOP powers and the circumstances in which they might be used. However, making intervention mandatory at certain trigger points could reduce supervisory flexibility and more consideration is needed of such a proposal.

The mechanics of how an OiVOP would operate in practice are not wholly clear. But we would be concerned if the regulators used an OiVOP, for example, to send a message of deterrence to the wider market, even where the individual firm concerned had agreed to take effective corrective action.

More fundamentally, the subsequent publication of a supervisory notice would amount to public censure as the notice would be publicly critical of a firm’s conduct. This would not be comparable to the current practice of amending a firm’s permissions on the FSA’s public register. Public censure requires due process involving a warning notice, representations to the Regulatory Decisions Committee, a decision notice (which can be referred to the Financial Services and Markets Tribunal) and a published final notice. The publication of warning and decision notices is prohibited by the FSMA.
In short, we believe there is a danger that an extension of the use of OiVOPS could blur the line between supervision and enforcement, amount to public censure in all but name and deprive firms of their right to due process.

21 What are your views about changes that may be required to enhance accountability within the SRR, as described in paragraphs 6.21 to 6.24?

We have no comments on these proposals.

Impact assessment

22 Annex B contains a preliminary impact assessment for the Government’s proposals. As set out in that document, the Government welcomes comments from respondents on the assumptions made about transitional and ongoing costs for all types of firm. In particular, comments are sought from all types and size of deposit-taking, insurance and investment banking firms (including credit unions and friendly societies), and from groups containing such firms.

We believe that the costs of moving to the new system will be considerable. We also believe that there is a considerable risk that the ongoing costs of the new regime will be higher than the existing regulatory regime.

It is stated in the impact assessment that the Government is considering whether to extend “supervisory powers to cover unregulated holding companies and unregulated entities within the Group structure of financial institutions such as banks and insurers”. This proposal requires further thought and any changes need to be proportionate. To adequately supervise a Group’s unregulated entities the PRA would need to significantly increase resources. Under the current regulatory structure supervisors can request any information that is required on an unregulated holding company or an unregulated entity. The FSA also already considers any potential for contagion risk from these entities on the regulated firm.