

14 April 2011

Emil Levendoglu
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Dear Emil,

A New Approach to Financial Regulation

The Investment Management Association (IMA) thanks you for the opportunity to comment on the above paper.

The IMA represents the asset management industry operating in the UK. Our Members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of £3.5 trillion of assets, which are invested on behalf of clients globally. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In relation to the market facing issues, our member firms are a significant part of the buy-side voice in the capital markets.

We are grateful for the time taken by members of the Bill team to attend our members meeting and for our participation in an HMT stakeholder event.

Our responses to the specific questions are attached. There are many important details and much we support. Two overarching issues deserve mention here:

First, Government's continued rejection of a need to have regard to competitiveness. Our members compete in a global market and their local market is the EU. Gold-plating, inconsistent approaches in supervision and front-running EU and international initiatives are competitiveness issues. The FCA must be expected to have regard at least to the Single Market, recognising it will principally be a supervisor.

Secondly, the need to provide much greater legislative certainty on issues of fairness and predictability:

- Regarding costs – including fairness:
 - in relation to the liabilities, unfair taxation bases and moral hazards arising from the design and operation of the compensation scheme arrangements – this is addressed under Q.29;

65 Kingsway London WC2B 6TD

Tel:+44(0)20 7831 0898 Fax:+44(0) 7831 9975

www.investmentuk.org

- as between all firms for the costs of the ESAs – this is addressed under Q.32; and
 - as to the cost of reporting data when compared with the use made of it by the FCA (an NAO project) – this is addressed under Q.12.
- Regarding certainty of expectations – including:
 - as to what is and is not guidance – especially in light of FSA's apparent disregard of s.157 and 158 FSMA for thematic and general recommendations until recently when we presume a need has arisen to identify what will be transitioned into the new regulator as a rule or guidance. Firms have not previously had this certainty about the standing of such reports and speeches;
 - as to consistency in supervisory approaches and financial promotion decisions; and,
 - revising the RAO and Permissions regime to ensure one to one conformity with EU legislation – this is addressed under Q.19.
 - Regarding process and representation – including fairness:
 - in relation to discipline and intervention having regard to the lessons from the Enforcement Review and public law requirements – this is addressed under Q.14;
 - by ensuring the Practitioner Panel has a role in the PRA – this is addressed under Qs.5-10; and
 - in the operation of the PRA veto to prevent competitive distortion and limits on consumer redress – this is addressed under Q.13.

We would expect to work with you on all these issues and those raised within the attached responses, if requested. If we can be of further assistance, please do not hesitate to contact us.

Yours sincerely



Guy Sears
Director, Wholesale

2. Bank of England and Financial Policy Committee

Ad-hoc tools created for specific circumstances

1. *What are your views on the likely effectiveness and impact of these instruments as macro-prudential tools? (Box 2.D)*
2. *Are there any other potential macro-prudential tools which you believe the interim FPC and the Government should consider? (Box 2.D)*

(Questions 1 and 2) We have no additional proposals; the need for wide and flexible powers is understandable but more important will be the need to maintain a determination to secure global co-ordination and co-operation if macro-prudential tools are to be of wide benefit.

Interaction with monetary policy

3. *Do you have any general comments on the proposed role, governance and accountability mechanisms of the FPC? (Box 2.F)*

It will be essential for the FPC to draw upon the widest sources of intelligence and analysis of developments in the market. In particular we believe that the buy side has a distinct perspective from that of the sell side, and the FPC will need to seek input from investors as well as from the market itself. There were a number of times in the course of the crisis when the authorities appeared to be hearing different assessments from buy and sell sides respectively.

We recommend that, in appointing members of the Committee, care is taken to ensure a significant representation of members with buy side experience.

Coordination

4. *Do you have any comments on the proposals for the regulation of systemically important infrastructure? (Box 2.G)*

We have no particular comments other than agreeing that EMIR will likely require further changes to FSMA and major changes to RCHs ahead of this in the Bill may prove redundant. Co-ordination with FCA Markets and ESMA will be key to managing risk and maintaining confidence in the markets.

3. Prudential Regulation Authority

(Questions 5 – 10) We understand from your papers and discussions with yourselves, that as asset managers, whether investment or fund managers, our members will be principally regulated by the FCA. Therefore we have not made comments upon the specific objectives and powers of the PRA. Many asset managers outside insurance groups will themselves have an insurance subsidiary and these captive vehicles will need PRA regulation. We still hope that such special captive vehicles could be exempt from PRA regulation but if they are not, it will be important to ensure the PRA's involvement and the co-ordination mechanisms are not disproportionate to the risks involved.

We think the Practitioner Panel's involvement in the PRA, not merely for consultation purposes, but to identify business impacts and gaps and inconsistencies, would be beneficial. The Consumer Panel could similarly assist the PRA.

We address supervision issues under section 5.

4. Financial Conduct Authority

Regulatory Principles

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

We are pleased to note the Government's comments in 4.9 that the FCA will be "an entirely impartial regulator" and "will pursue its outcomes in a way which recognises not only the limitations of regulation, but also the potentially negative effects of excessive regulation on market efficiency and consumer choice"; we agree that "proportionality will be critical" and "the concept of the responsibility of consumers for their own choices will also be important".

We welcome the proposed strategic objective, which itself contains two ideas, that of protecting and that of enhancing. We note that they are to be seen as a single objective. We support the use of the introductory language "must, so far as is reasonably possible".

As regards the first operational objective, we welcome the recognition that the FCA also has an important role in removing regulatory barriers, especially in relation to wholesale markets. Nevertheless even in that regard, we welcome the association of the term consumer with all types of retail customers, financial professionals, financial firms and large corporations.

As regards the second operational objective, we agree there should be a proportionate response between the levels of protection afforded different types of consumer.

We agree with the third objective including the need to counter financial crime (as particularised in Box 4.C). It will be important that FCA is clear as to how its requirements interact with guidance produced by the Joint Money Laundering Group.

We also consider that the FCA should have a prudentially-focussed operational objective. We acknowledge the points made in Box 4.e that commonly FCA's focus will be more on preventing consumer detriment than on avoiding failure. However comments in that Box also state:

"The FCA will, however, pursue more proactive and intensive prudential supervision for a very small population of 'prudentially significant' firms, where the FCA considers that the firm's failure could individually undermine any of the FCA's objectives."

Whilst at a fundamental level, objectives are written to provide legal cover for the regulator, they also provide an operational focus. It follows that we consider an additional operational objective should be: "promoting the safety and soundness of FCA authorised persons".

Narrowly, the proposed statement of strategic and operational objectives does not require the FCA to balance the operational objectives between themselves. Published strategic

plans of the FCA, not merely at commencement, must demonstrate to what extent different operational objectives are to be advanced.

We support the proposal that the FCA is to exercise its general functions in a manner intended to promote competition and are pleased that this has been elevated above a "have regard" approach taken in the existing legislation. We acknowledge that the competition mandate needs to be balanced carefully alongside the primary objective of the FCA. We think, however, the fostering of competition will rarely be incompatible with the FCA's strategic objective or any of its operational objectives.

We note the proposal that the FCA must have regard to six regulatory principles. We agree that public understanding should be a matter for the Consumer Financial Education Body.

We agree that issues of financial inclusion are better expressed as Government policy on social issues.

We note your rejection of an explicit factor to contribute to competitiveness of the UK economy, which we had wanted; but we note that you see the FCA playing a vital role in promoting clean, fair and efficient markets that make "London" (and by association the UK) a world leading location for financial services activity. Nevertheless we think competitiveness is an important factor to which the FCA should have regard; although perhaps the definition is too narrow to be confined to the single market as many firms within FCA invest globally - the government has a global competitiveness agenda and therefore so should FCA.

The gold-plating by the FSA over directives, particularly as regards transaction reporting which has cost firms considerable amounts of money, is a matter of competitiveness. So is the insistence of the FSA to front-run EU initiatives or inconsistencies of approaches compared with other EEA supervisors. Such competitiveness issues, relating to the fact of firms operating in the single market, should be addressed in the new legislation.

As regards the decision not to have reference to an innovation factor, in our previous response we had wanted the FCA to have regard to innovation of some kind (recognising the misapplication by some of the label to ill-considered products). We consider, however, this could be met by the regulatory objective of facilitating efficiency and choice in the market for financial services, and would welcome confirmation of this.

Governance & Accountability

12. What are your views on the Government's proposed arrangements for governance and accountability of the FCA? (Box 4.D)

We agree that using the existing FSA company as the FCA ought to secure a lower cost transition.

We welcome the ability for the NAO to audit the FCA, for which we had called in the past.

We shall want the NAO to consider the cost of data and reporting and how that is used, for which we have also called in the past.

We welcome the continuation of the existing Panels, the statutory recognition of the Smaller Business Practitioner Panel and the creation of a Markets Panel. Wide and balanced representation on each will be critical.

Transparency and fairness of decisions will be important. In this regard we identify in our answers areas in which we consider the legislation should better specify obligations of fairness:

- Regarding costs – including fairness:
 - in relation to the liabilities, unfair taxation bases and moral hazards arising from the design and operation of the compensation scheme arrangements – this is addressed under Q.29;
 - as between all firms for the costs of the ESAs – this is addressed under Q.32; and
 - as to the cost of reporting data when compared with the use made of it by the FCA (an NAO project) – this is addressed above.

- Regarding certainty of expectations – including:
 - as to what is and is not guidance – especially in light of FSA's apparent disregard of s.157 and 158 FSMA for thematic and general recommendations until recently when we presume a need has arisen to identify what will be transitioned into the new regulator as a rule or guidance. Firms have not previously had this certainty about the standing of such reports and speeches;
 - as to consistency in supervisory approaches and financial promotion decisions; and,
 - revising the RAO and Permissions regime to ensure one to one conformity with EU legislation – this is addressed under Q.19.

- Regarding process and representation – including fairness:
 - in relation to discipline and intervention having regard to the lessons from the Enforcement Review and public law requirements – this is addressed under Q.14;
 - by ensuring the Practitioner Panel has a role in the PRA – this is addressed under Qs.5-10; and,
 - in the operation of the PRA veto to prevent competitive distortion and limits on consumer redress – this is addressed under Q.13.

We welcome your imposing a duty on the FCA to report on itself when there is a regulatory failure, much will depend on how that term is defined; and we welcome the retention of the section 14, FSMA power as a backstop power to require investigations into the FCA's conduct.

We would trust that a Complaints Commissioner will be part of the accountability mechanism of FCA.

New product intervention powers

13. What are your views on the proposed new FCA product intervention power? (Box 4.F)

In principle, we think it is right that the FCA should have a power to intervene in relation to products. What the words “intervene” and “products” mean is the real issue.

We agree that detriment can arise from misconduct in a single firm or from issues affecting a sector or type of product. We are concerned with the suggestion at 4.54 that significant detriment is “more often likely to arise” from such wider issues. On the one hand, it is legitimate for the Government to propose that the FCA has product intervention powers based upon recent experience. However, the defaults of intermediaries which have led to levies of over £420 million being imposed in the last two financial years by the FSCS are better described as failures in single firms than as issues across a whole subsector or type of product. Moreover, the products involved in those cases have not been UK-based, so a new product intervention power might not be able to be used – it was UK or cross border distribution that was at fault. Accordingly, we think it is not controversial amongst lawyers that uses of the existing OIVOP powers could have prevented these sales. This is not an issue principally about failure of design of powers, but of execution.

We would caution against all the FCA's eggs being placed in one basket. Regulatory approaches by the FSA have all too often been characterised by slogans such as “principles based regulation” and “treating customers fairly”. Each slogan had merit in its own right but they too often came to dominate, and constrain, supervisory approaches. It is important that FCA does not become slogan-led or subject to fashion but retains both the flexibility to address unforeseen (or previously overlooked) issues and the willingness to use its full range of powers.

Clear ownership by individuals in senior management of key initiatives, such as the RDR, would assist with accountability and quality of output.

We consider that the current manner in which the FSA determines whether any firm poses a significant risk to its objectives has not been a success, measured by the number of complaints have had to be upheld by the Financial Ombudsman Service (“FOS”) and by the level of compensation that has had to be paid by the FSCS. The processes for determining the types of engagement with different firms and the MI captured needs to be redeveloped.

It may not be profitable to rehearse the number and width of powers available to the FSA which could have been used to address previous failures. There have long been powers, since the Financial Services Act 1986, to restrain activities which are in breach of the rules, including poor sales processes and the issuance of misleading financial promotions. As the paper recognises at 4.60, the FCA will be able to take action using existing regulatory powers, to make rules to place requirements on products or product features; mandate minimum product standards; or restrict the sale of a product to a certain class of consumers.

The new proposal is to legislate to enable the FCA to make temporary product intervention rules for a period of up to 12 months where it considers it expedient to meet its operational objectives. We note the reference in this regard to the making of rules. We presume this identifies that although a particular product being prepared or manufactured by an individual firm has attracted the FCA's attention, the intervention power will operate against any

product of that type without discriminating between individual firms. The most closely analogous powers presently available against individual firms are the OIVOP power and the power under s.380(1)(a) FSMA to obtain an injunction where the court is satisfied “that there is a reasonable likelihood that any person will contravene a relevant requirement”.

Given our assumption that the product intervention rules will operate against a class of firms, then no longer will the regulator (FSA/FCA) need to show that an individual firm has or may breach a requirement in a manner that would presently be actionable. Whilst we support the proposal to have principles published, we consider that the principles under which this power should be exercised should be described in legislation and not left wholly to the FCA. We suggest that one way of looking at this power is to see it as reflecting a change of balance between the pursuit of individual rights and the protection of the wider society. Whilst this is fairly usual territory for regulatory rules, given the impact of these particular rules and the lack of any remedy for firms unfairly denied a business opportunity then, at the very least, the legislation should make provision for the matters identified in 4.64 to be addressed in the principles (these are greater clarity and certainty to industry about expectations in relation to product design and product governance, and codifying the need for proportionate application of such power to reflect that it is unlikely to be appropriate in relation to professional or wholesale customers).

It must appear likely in framing the new product intervention power as a rule-making power that the PRA might have a veto in relation to only some of the firms that might be covered. This could be unfairly distorting.

We recognise there will be a need for coordination with the PRA and refer to this in chapter 5. As we explain there, we are concerned to ensure that the PRA's views about balance sheet impacts will not be allowed to stifle appropriate action to protect consumers.

We welcome the fact that the preventive approach will not be focused purely on retail products and services but will consider the full value chain. We shall continue to raise with the FCA, as we have unsuccessfully with the FSA, our concern that the regulator has not seen the "battle of the forms" regarding the terms of business between the buy-side and sell-side as a market failure some 18 years on from when it was first identified in documents¹ by the Financial Markets Law Panel (as it then was).

Finally, it will not have passed Government's notice that product intervention may be incorporated in MiFID II and will be debated at the time that any UK Bill is being considered. Given Government's proposals and the Commission's statements to date, we would be surprised if the UK had to do more to meet any new EU approach; and if need be s.2 of the European Communities Act 1972 can be used to implement them.

Early publication of enforcement action

14. *The Government would welcome specific comments on:*

- *the proposed approach to the FCA using transparency and disclosure as a regulatory tool;*
- *the proposed new power in relation to financial promotions; and*
- *the proposed new power in relation to warning notices. (Box 4.G)*

¹ <http://www.fmlc.org/papers/FLPAgencyFundMan.pdf> and http://www.fmlc.org/papers/flp_050926b.pdf

We recognise that a context of the Government's review of the regulatory regime includes:

- There have been over 900,000 complaints to FOS.
- In the financial year 2009/2010 four of the UK's largest financial services groups accounted for 84,718 cases at the FOS (52% of all the complaints received).
- Over £420 million has had to be raised by the FSCS for intermediary defaults in the last two financial years.

We do not therefore oppose these proposed new approaches and powers.

However, their existence places an even greater burden on the FCA to ensure that its internal processes are of the highest standards. In this regard we remind Government of the criticisms made by the Financial Services and Markets Tribunal (as it was) in the Legal and General case and which led to the enforcement process review² by the FSA.

The speed at which the FCA may be expected to act in relation to some of these new powers demands a much more explicit statement of the processes and protections be put in place (or preserved in the transition from the FSA). As the Tribunal stated (our underlining):

"We have had much more time than the RDC to consider all the issues and have had the benefit of much more evidence than they had available to them. In our view the RDC was in error in its approach to the mis-selling case and reached conclusions not justified by the material before it."

And as the subsequent FSA review stated:

"It is clearly important that the FSA should listen carefully, and react, to informed and considered criticism; and that those subject to FSA enforcement, and their advisers, should consider that the process has been fair, irrespective of whether they like a particular decision. This report demonstrates the FSA's determination to respond carefully and fully to well-founded criticisms."

In approaching this Review, we wanted to re-establish confidence in the fairness of the FSA's enforcement process. We are proposing a number of changes designed to make the process more rigorous, and to establish much more clearly the division of responsibility and separation of operations between those in the FSA who prepare an enforcement case and those in the FSA who make the decision on that case. Essentially, this means the separation between supervision and enforcement on the one hand and the Regulatory Decisions Committee on the other. But we also wished to maintain an administrative decision-making process which involves neither excessive cost, nor too much time. It is important for all affected by enforcement that the costs should be kept as low as possible, and that decisions should not be unnecessarily delayed."

This seems to us the manner in which the FCA should proceed. But we note that the FSA was not required by the legislative framework to have this approach and moved to it only in the light of "well-founded criticisms". For that reason, we would expect the legislation to expect proper separation of aspects of the investigation and decision-making processes within the FCA. It is entirely possible for legislation to provide sufficient detailed protections.

² http://www.fsa.gov.uk/pubs/other/enf_process_review_report.pdf

As regards the specific powers:

Transparency – At 4.75, Government states that the FCA should make greater use of existing powers to make disclosure itself, *or require disclosures by firms* (our emphasis). The ability to make a rule requiring disclosure by a firm cannot be used to require publication of information which the FSA (now) and the FCA (in future) could not have published for reasons of professional secrecy (as European law would describe it). A rule requiring disclosure can relate only to the medium of publication (by the firm rather than the FCA), so we welcome the recognition given to this constraint at 4.75.

Financial promotions - The implementation of MiFID and the conditional and qualitative approach to disclosures (as in, “if a firm states, then” or “fair, clear and not misleading”) should have proved beneficial in that firms could distinguish themselves rather than becoming hidebound by meaningless but prescribed prosaic. So, publication of what has been withdrawn could be useful to assist others in better understanding the boundaries. But we fear publishing what was withdrawn and why will only lead to more risk-averse firms becoming more conservative and less risk-averse firms pleading precedents in aid to be allowed to continue.

It is a matter of record that the FSCS expects to pay some £247.4m based upon claims arising from what the FSCS sees as misleading brochures issued by Keydata Investment Services Limited about an investment plan. In that case, we query how this power would have worked given the brochures were distributed to a number of IFAs. Is it expected that Keydata would have immediately contacted all IFAs and told them to discontinue using it or would each IFA have been told of the decision by the FCA (especially since usage of a brochure by another regulated firm is that firm’s own responsibility)? It is critical to ensure these powers will work in practice for issues such as Keydata which is one of the largest non-bank failures (measured by loss compensated) in the FSA period.

Warning notices – our comments at the start of this answer about the lessons learned from the Enforcement Review are particularly apposite here. We acknowledge that if the FCA commenced proceedings in the courts then that fact would invariably become public, even before a defence were served, let alone trial. We agree that with the safeguards set out in 4.89, the FCA should have a discretion and not a duty to publish and that the discretion should also provide that notices against individuals might not be published even when a related notice against a firm is published; and that references to individuals could be redacted.

We presume that the references to safeguards relate to the question of publication; there should be no suggestion that any procedural fairness necessary before that step, including Maxwellisation, would be avoided.

We do not consider the publication of a warning notice is a free speech issue as regards the FCA and therefore the FCA should be required to ensure any comments (including in the summary) are limited to a fair and accurate report of the steps taken.

New role and powers in competition

15. *Which, if any, of the additional new powers in relation to general competition law outlined above would be appropriate for the FCA? Are there any other powers the Government should consider? (Box 4.H)*

We consider that both options mentioned could be adopted. In retail consumer matters, the Consumer Panel could have the power to trigger the super-complaint process, whilst allowing the FCA a wider obligation to keep competition under review and be able to make a market investigation reference, as well as respond to a super-complaint from the Consumer Panel.

We welcome the further detail promised by Government.

Wholesale and markets regulation

We agree with the points made in 4.99 to 4.107. We refer again to the lack of apposite and agreed terms in the cash markets (see our response to question 13 above).

Enforcement

It seems sensible to ensure the FSA's criminal powers are moved to the FCA – indeed, as we have previously noted, the Market Abuse Directive permits only a single competent authority in each Member State of the EU. This needs to be the FCA.

European representation

16. *The Government would welcome specific comments on:*

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

We have no adverse comments about the proposed changes to powers; these appear useful clarifications and extensions.

We agree that Government should keep Part XVIII as it is and await any required changes from MiFID II and then use s.2 of the European Communities Act 1972 to implement them (even though this may require a greater alignment of MTFs with RIEs).

5. Regulatory Processes and Coordination

Cross membership of boards

17. *What are your views on the mechanisms and processes proposed to support effective coordination between the PRA and the FCA? (Box 5.A)*

We expect that all our members will be regulated directly only by the FCA; though some are in groups which contain PRA firms as well and many will have insurance subsidiaries. In this regard, we support the proposed duty to coordinate as explained in 5.11 of the HMT paper. As regards an MoU, we would stress that it will need statements as to timeliness of responses and decisions.

Managing the risk of disorderly firm failure or threat to financial stability

18. *What are your views on the Government's proposal that the PRA should be able to veto an FCA taking actions that would be likely to lead to the disorderly failure of a firm or wider financial instability? (Box 5.B)*

We remain concerned that the PRA veto must be seen to be an extreme event, particularly if limiting or preventing steps to secure redress for consumers. In particular, it would be helpful to understand whether any of the existing widespread consumer detriment issues seen by FOS might have been subject to a veto. We note the veto should be notified to Parliament unless contrary to the public interest, including financial stability and confidentiality. We are not sure what circumstances would lead to the exercise of the veto that would be compatible with such publication or inclusion in the PRA's annual report.

Accordingly, we consider the chair of the TSC and the chairs of the Panels should be informed in any event of the use of a veto.

Variation and removal of permission

19. What are your views on the proposed models for the authorisation process – which do you prefer, and why? (Box 5.C)

We support the alternative approach under which FCA would be responsible for processing the application by an asset manager either itself to be authorised (and even if in a group) or in particular to form a captive insurance vehicle.

In addition to the process issues raised in the paper, we would like to see a revision to the multi-layered expression of permissions through the RAO interacting with the EU directives which regulate most activities (and authorisations) seen amongst our members.

Permissions: The RAO, FSMA, MiFID and the FSA

Issue

The FSA authorises firms to conduct regulated activities. The RAO sets out the activities which, under FSMA, require regulation. MiFID sets out a range of activities and services which firms must perform in line with the standards set out in that directive. UCITS sets out similar activities and standards for collective investment scheme operators.

Increasingly regulated activities in the UK draw their ultimate origin from European Directives. If the terms used in the UK do not match up with those set out at the European level this can lead to uncertainty and legal expense.

This seems like an ideal opportunity for the three (Directives, RAO and Permissions) to be properly aligned. It would save a considerable amount of time and money at firms, their advisers and regulators if the RAO were to be substantially rewritten to reflect Annex I of MiFID and Annex II of the recast UCITS Directive and to mesh with 2BCD and Solvency II. This would, ideally, provide an inclusive approach to most permitted activities, e.g. a firm with permission to conduct portfolio management would be thereby permitted to conduct all directly related activities (e.g. dealing in investments as agent, making arrangements with a view to transactions in investments etc.) and would not need a raft of extra permissions to be appended to their main permission.

Additionally the current regime encourages the mistaken view that particular permissions represent real business activities. One recent example was bank levies, where the reference to the dealing permission would have captured investment managers placing orders resulting from decisions to invest, which would have made the UK unique in the EEA. The RAO could have been revised at MiFID; we think it now should be.

Current Situation

Currently a small straightforward asset manager may need the following permissions (and despite Schedule 5 of FSMA):

- *Managing investments*
- *Establishing, operating or winding up an unregulated collective investment scheme*
- *Advising on Pension Transfers and Pension Opt Outs*
- *Advising on investments (except on Pension Transfers and Pension Opt Outs)*
- *Agreeing to carry on a regulated activity*
- *Arranging (bringing about) deals in investments*
- *Arranging safeguarding and administration of assets*
- *Dealing in investments as agent*
- *Dealing in investments as principal*
- *Making arrangements with a view to transactions in investments*
- *Safeguarding and administration of assets (without arranging)*

These are then further complicated, as each permission is granted for a range of investment instruments (see a sample list below), for certain types of customer and is yet further overlain by specific limitations.

Investment Instrument

Certificates representing certain security

Commodity Future

Commodity option and option on commodity future

Contract for Differences (excluding a spread bet and a rolling spot forex contract)

Debenture

Funeral plan contract

Future (excluding a commodity future and a rolling spot forex contract)

Government and public security

Life Policy

Option (excluding a commodity option and an option on a commodity future)

Personal pension scheme

Rights to or interests in investments (Contractually Based Investments)

Rights to or interests in investments (Security)

Rolling spot forex contract

Share

Spread Bet

Stakeholder pension scheme

Unit

Warrant

Customer type

Eligible Counterparty

Professional

Retail (Investment)

The Permission Statement for a simple firm can fill seven pages.

Proposal

These permissions could be considerably simplified, for instance managing investments could be recast as portfolio management, to bring it in line with the MiFID terms, and deemed to include any activity ancillary to that service, such as:

- Agreeing to carry on a regulated activity
- Arranging (bringing about) deals in investments
- Dealing in investments as agent
- Dealing in investments as principal
- Making arrangements with a view to transactions in investments

Schedule 5 of FSMA provides a model.

The operator of a CIS could be granted one permission to establish, operate or wind up a regulated or unregulated collective investment scheme, in line with UCITS. This could be deemed to include:

- Acting as the depositary or sole director of an open-ended investment company
- Agreeing to carry on a regulated activity
- Arranging (bringing about) deals in investments
- Dealing in investments as agent
- Dealing in investments as principal
- Making arrangements with a view to transactions in investments

We think the RAO should be re-cast and the FSMA permissions and (FSA) Register aligned so that firms and the public can plainly see what a firm is able to do, legal uncertainties are reduced and the regime is understood from the point of view of the businesses that are regulated. Obviously the scope of regulation, the perimeter, will need careful thought but this should not be allowed to continue an opaque regime in which firms have little understanding as to its role and where the need to have so many permissions prevents regulators and policymakers from targeting rules correctly. This becomes especially so where firms are then seen, in recent tax or levy legislation for example, as belonging to some type of business model because they have a dealing permission when that is a UK requirement placed on portfolio managers.

20. What are your views on the proposals on variation and removal of permissions? (Box 5.C)

We agree in relation to the FCA powers. As our members are principally regulated by the FCA we have not made comments upon the specific coordination mechanisms beyond noting that as many asset managers outside insurance groups will themselves have an insurance subsidiary, these captive vehicles will need PRA regulation.

We had hoped that such special captive vehicles could have been exempt from PRA regulation but as it appears they will not, it will be important to ensure the co-ordination mechanisms are not disproportionate to the risks involved.

Approved persons

21. *What are your views on the Government's proposals for the approved persons regime under the new regulatory architecture? (Box 5.D)*

We agree in relation to the FCA powers. As our members will be principally regulated by the FCA we have not made comments upon the specific coordination mechanisms. See our comments above in 20 concerning captive insurance vehicles.

Passporting

22. *What are your views on the Government's proposals on passporting? (Box 5.E)*

We agree in relation to the FCA powers. As our members will be principally regulated by the FCA and unlikely to need passporting for any captive insurance vehicle, we have not made comments upon the specific coordination mechanisms.

Mutual organisations

23. *What are your views on the Government's proposals on the treatment of mutual organisations in the new regulatory architecture? (Box 5.F)*

We have nothing to add.

Rule waivers

24. *What are your views on the process and powers proposed for making and waiving rules? (Box 5.G)*

We are unclear as to why a wider consultation power is being proposed here. It states that where a waiver is granted to a firm entirely regulated by the FCA but which is in a group in which there is a dual-regulated firm, then the PRA must be consulted. We consider this is unnecessarily bureaucratic for rule waivers which could not impact prudential oversight. But we also have a concern as to how rule waivers for complaints handling are used. At times it is perfectly understandable in light of the need to clarify legal issues or co-ordinate wider issue resolution, but there is a concern that it could be used to protect fragile balance sheets so denying prompt redress for consumers.

Supervision of financial groups (and unregulated holding companies)

25. *The Government would welcome specific comments on*

- *proposals to support effective group supervision by the new authorities – including the new power of direction; and*
- *proposals to introduce a new power of direction over unregulated parent entities in certain circumstances? (Box 5.H)*

The consultation states that various EU Directives (including CRD and the Financial Conglomerates Directive), informed in part by the Basel Concordat, require the 'consolidated supervision' of firms carrying out specified activities within a group. Although the text says the consolidated supervisor will predominantly be the PRA, we would expect a large number of asset managers to be lead regulated by FCA despite the presence of a captive insurance

vehicle. As long as the PRA veto over directions is kept at the very high level suggested in 5.70 (reasons of financial stability or disorderly failure) then we think this ought to be workable. It is important that the FSA states clearly and in good time how it envisages the new bodies will deal in practice with such consolidated supervision. We have no comment about UK unregulated entities.

Change of control and Part VII Transfers

26. *What are your views on proposals for the new authorities' powers and coordination requirements attached to change of control applications and Part VII transfers? (Box 5.I)*

On change of control, we agree the PRA must be consulted and could object if the change relates to a firm entirely regulated by FCA but which is in a group in which there is a dual-regulated firm.

We have no further comments on Part VII transfers.

Insolvency

27. *What are your views on the Government's proposals for the new regulatory authorities' powers and roles in insolvency proceedings? (Box 5.J)*

The PRA's veto should only allow it or the Bank of England to proceed to resolve the firm concerned. The FCA should not be left in a position where a regulated firm is insolvent but action is prevented or delayed.

Actuaries and auditors

Although no question is asked directly, we support the extension of powers to ensure individuals might be disqualified. We are presuming all necessary procedural protections will be provided to any individual facing such a risk.

Fees and Levies

28. *What are your views on the Government's proposals for the new authorities' powers in respect of fees and levies? (Box 5.K)*

As to substance, it will be critical to ensure the costs of the FCA are attributed fairly across all firms. The legislation should address these issues by setting out principles of 'taxation' to which FCA and PRA must have regard. The cost of markets work should also be borne by wholesale firms which are only regulated by PRA. We address the costs of the ESAs under section 7 below.

As to mechanism, we have no comment on FCA operating this process.

6. Compensation, dispute resolution and financial education

Governance

29. *What are your views on the proposed operating model, coordination arrangements and governance for the FSCS? (Box 6.A)*

Whilst we have no objection to there being a single legal entity, FSCS, for contact purposes, we have not yet understood how it is envisaged the various scheme rules will be made and how they will relate.

It is unclear to what extent the PRA will be able to make rules. The paper states it will for “insurance provision”. Does this include insurance mediation? And what of mortgage intermediation? Certainly the proposal that the FCA will be able to make rules “relating to all **other** types of financial activity” (our emphasis), makes it no clearer.

Despite the FSA recommending its funding review, the legislation must:

- Subject to what follows, provide sufficient flexibility to permit any outcomes of that review to be implemented;
- Expect the rules to ensure fairness between levy payers, including as regards their prudential requirements;
- Expect cross-subsidy, if it persists, only to relate to relationships between manufacturers and the sales of their own product lines;
- Expect the rules to seek as far as practicable to provide budgetary predictability
- Provide a role for HMT in approving the rules;
- Start from a basis that is objectively justifiable and not merely an echoing of old SROs and regulatory structures;
- Only depart from EU requirements where there is justification having regard to the accessibility of products on a cross-border basis which may not have to bear compensation costs.

The current regime has not met these requirements.

The lack of predictability of levies was made apparent when FSCS demanded a £233m cross-subsidy on SD01 at the commencement of the calendar year on a month’s notice. That constitutes around 4% of gross retail income without the deductions that a tax might allow.

The rules and what constitutes income relevant to the setting of the tariff are not sufficiently clear.

A further indefensible feature of the present Scheme is the trigger for compensation. The Scheme processes claims when **a** liable firm has defaulted not when **every** liable firm has defaulted. In the case of Keydata, the majority of all sales were intermediated by other UK regulated firm which we presume are likely to have owed a duty to consider suitability and may have had co-liability for the Keydata brochures. Whether or not in fact any particular firm did or does is not known or implied by us – and it is not relevant to the point being made. What matters is that there appeared to be no rule requiring examination of any potential liabilities that any other regulated firm in the UK (that is, beyond Keydata) may have to its clients prior to a determination to pay out investors.

The new rules, covering FSCS, should consider the likelihood of another UK regulated firm paying the self-same investor which was its client for conduct of business purposes and expect FCA to take action. Where several firms may have liabilities to an investor for the same event, down a sales or marketing chain, we would have expected that all the firms would have to go through complaints handling and determine what compensation if any should be paid to customers. If that had been a requirement imposed on all firms connected with the sales, it may have secured faster payment to clients and without the intervention of the FSCS.

We do not know what liability any firm may have in the particular case, but we note the *ex gratia* payment announcement of over £50m by Norwich and Peterborough Building Society. Had that been obtained by the FSCS before paying investors and therefore had the regime expected the FSA to seek to recover first from any other regulated firms that might be liable, the FSCS would have needed some £50m less to be levied from the industry for a start. The rules do not envisage a co-ordinated response by the regulatory structure (FSA and FSCS) both to compensate investors but also to ensure the cost of failure is placed at the feet of those primarily liable (even if a residual sum is still needed by FSCS from the industry).

The current approach relieves prospectively co-liable adviser firms from the need to handle complaints or account for their actions to their clients. The FSCS has to step in and pays clients and those adviser firms who may also be liable (and their insurers) only have to await a claim from FSCS. In the meantime those self-same clients may not consider they have been failed by their adviser firm; the payment by the FSCS relates in name to some other person in the chain (here Keydata), and so the clients continue to use that firm rather than going to a new adviser. This is an indefensible structural moral hazard.

Moreover, we now fear a precedent has been set that the default of a promoter (Keydata) in the UK can provoke the payment of compensation to holders of bonds in a Luxembourg entity (Lifemark) which is still operating, and several years before investors would have had any expectation of receiving any return on their investment. We do not understand the policy justification for this state of affairs, especially combined with the effective amnesty from client action provided to any liable intermediary.

The current cross-subsidy arrangements are manifestly unfair in considering every variety of investment business as belonging to a class that can be split between two sub-groups. This is unfair not only to our members (as shown in Keydata etc) but also to many IFAs expected to bear the burden of failures such as Square Mile and Pacific Continental. The sales of offshore structured products, boiler room sales of unlisted shares and the liabilities for misleading brochures need to be much more thoughtfully considered.

The current cross-subsidy arrangements impose an unfair burden upon fund management (SD01) members compared to intermediaries (SD02). The current annual cap on SD01 is £270m and on SD02 is £100m. According to FSA and FSCS, the total eligible income pool for SD01 for 2010/11 was £6,065 million (we have always thought that an overstatement) and for SD02, the investment intermediation sub-class, £3,701 million.

This is equivalent to a maximum 4.45% levy on SD01 and 2.7% on SD02. There is no justification for this. On such figures the cap for SD01 should be at £164m (even on the overstated £6bn figure).

The unfair tax bases are reinforced by the different capital treatments of firms in the different classes. Many firms in SD02 are not subject to any significant capital requirement, which would support the levy basis being lower on SD01 (due to the relative lower risk of uncompensated loss). It is critical that new rules are made which are not influenced by a belief that asset managers are deep pockets which can be expected to bail out poor capitalisation, poor decisions or poor regulation.

Whilst we support the notion of operational independence of the FSCS, its practice of operating to a different levy year than provided in the rules as the basis for contributions between classes can be argued to have led to a reallocation of over £45m of liabilities between classes this year. Practice and rules should be aligned especially as we remain unconvinced that the unfettered discretion given to the FSCS on constructing levies properly reflects the protections expected under Article 1 of the First Protocol to the Convention on Human Rights.

We recognise that a number of the points we have made may not be directly a matter for primary legislation. But it is important that the enabling powers should be such as to allow the replacement of the present Scheme with a fairer model. We are particularly concerned that the split rule-making powers may work against the interests of FCA-regulated firms.

Moreover, the proposals are tantamount to placing very substantial taxation power with the FCA and PRA under open-ended rule-making powers unscrutinised by Parliament or Government. In view of the need to ensure consistency and the competitive implications of this tax-raising power, we consider HMT should have a role in making or approving those rules.

Again this is an area in which there may be changes to the relevant EU directives as the Bill is progressing through Parliament.

Transparency

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

The proposals on clarity of roles and strengthening co-operation, as well as the feedback loop from FOS are understandable given the number of complaints FOS has to handle.

Accountability of FSCS, FOS and CFEB

31. What are your views on the proposed arrangements for strengthened accountability for the FSCS, FOS and CFEB? (Box 6.C)

We support these proposals.

7. European and international issues

Ensuring a consistent and coordinated UK position in international discussions

32. *What are your views on the proposed arrangements for international coordination outlined above? (Box 7.C)*

We think the proposals reflect the thought and engagement since the earlier paper on how to ensure these vital aspects are operated effectively and efficiently. We support these proposals.

However, the proposals do not explore how the costs of the ESAs will be met. Will PRA firms contribute to the costs of involvement with ESMA, or any payment made to ESMA, particularly as regards markets and accounting? How will such costs be apportioned?

We note that the PRA, as regulator of banks and insurers, will hold the UK seat on the European Banking Authority (EBA), it will therefore be at the forefront of regulatory change to the Capital Requirements Directive; however it will not regulate any 'limited licence firms.'

We are therefore mindful to ensure that the interests of this group is appropriately represented in such negotiations and that a proportionate approach continues in the application of this Directive to such firms, which do not trade on their balance sheet and are quite distinct from banks and insurers.

Recent experience of the analogous involvement of CEBS in the preparation of remuneration principles for investment firms was encouraging as it did indeed reflect a proportionate and mindful approach. Nevertheless in this respect, the MoU and lines of communication between the PRA and FCA will be key to ensure the interests of limited licence firms continue to be represented in European fora.

~