

Herbert Smith

Breaking up  
is hard to do:  
the next stage?

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May 2012



THE LONDON SCHOOL  
OF ECONOMICS AND  
POLITICAL SCIENCE ■



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# Breaking up is hard to do: the next stage?

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## Introduction

The reform of the UK's financial regulatory system took a step closer to finalisation in January, with the publication of the Financial Services Bill, currently going through Parliament. There have been significant changes to the proposals since the first consultation paper, published in July 2010. Whilst the broad outline remains the same, a lot of work has been done to clarify the objectives, remits and responsibilities of the different bodies, to address potentially paralysing coordination issues and to strengthen the accountability arrangements.

What has emerged is a 'Triple Peak' structure, with strong central bank involvement. The post-crisis focus on macro-prudential regulation is manifested in the creation of the Financial Policy Committee (FPC), to sit alongside the more familiar 'twin peak' regulators of micro-prudential and conduct of business regulation by the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA). Above them all looms the Bank of England, about to become the most powerful central bank in the world. And behind them, with its hands on the nation's wallet, stands the Treasury.

In our previous paper, we proposed seven key principles to guide the design of the new structure of UK financial regulation:

- ensuring that the new regulators have a clear and strong voice in Europe;
- that there is clarity of purpose and expectations as to what regulation can deliver;
- clarity of jurisdiction;
- adequate coordination;
- adequate independence balanced by appropriate accountability for the new authorities; and

- that the system as a whole is dynamic and capable of responding to rapid changes.

As the reforms progress through the critical legislative stage, and the articulation of broad visions is replaced by line by line scrutiny of statutory drafting by lobbyists and legislators alike, these principles should act as guiding lights. Financial regulation is always important, but the last few years have demonstrated that getting that regulation right has become critical to the economic and social welfare of ordinary citizens in a way in which it has never before. Financial regulation is not only a matter for extraordinarily well-paid financiers to worry about, but for the rest of society as well. The costs of bailing out the banks had a direct and disastrous effect on the real economy, the effects of which are still being felt. But even in normal times, families are exposed to the financial markets through their pensions; their bank deposits; their mortgages; their ISAs. And, as is increasingly clear, the provision of their schools, hospitals, libraries, police and other welfare benefits is in no small part dependent on their government's ability to borrow from the very markets it seeks to regulate, alone or in conjunction with others.

The most recent consultation document states that the Government's primary objective in reforming UK financial regulation 'is to fundamentally strengthen the system by promoting the role of judgement and expertise'.<sup>1</sup> The extent to which this can be achieved through legislation and organisational restructuring alone is questionable. You cannot legislate for judgement. Nonetheless, legislation creates the framework in which the system then operates; getting that framework wrong can have significant long term consequences.

This paper looks at the core elements of the new structure, focusing in particular on three key issues: *balance of*

*powers and coordination* of the different components of the new regime; the *objectives, remits and powers* of the FPC, Bank, PRA and FCA, particularly with respect to enforcement; and their *accountability*. Throughout it assesses the system's ability to respond to change and its engagement with Europe. It argues that whilst a great deal of work has been done, there are still a number of outstanding issues that need to be addressed.

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### Executive summary

The Financial Services Bill is a significant advance in the reform process, and much distance has been travelled since the reforms were first proposed nearly two years ago. There is still work to be done, however, though with the legislative process underway there is little time left in which to do it. We focus here on what we consider to be some of the most significant issues that remain to be addressed in the legislation, recognising that implementation will bring yet a new set of issues as the system beds down.

#### Coordination, balance and accountability in the new regulatory system

There is a considerable risk that the coordination failure between the FSA, Treasury and the Bank, will be replaced with a new set of coordination issues in the new 'Triple Peak' structure. The extent to which the new regulators coordinate on a strategic and daily basis, and ensuring that gaps are sealed, will be critical, if the benefits of breaking up the regulatory structure are not to be outweighed by the costs.

Considerable concerns remain in relation to the governance and accountability of the Bank of England. The lack of a requirement for the Bank to investigate its own regulatory failures is a worrying omission. Further, we support the significant reform of the Court of Directors, so as to create clearer lines of responsibility and external accountability. There are also glaring omissions, in that there is no statutory requirement for the Bank to coordinate with the FCA or PRA, nor is it subject to the general regulatory principles or the principles of corporate governance which apply to the PRA and FCA. It has perhaps been forgotten that the Bank is a regulator as well.

The constitution and composition of the FPC also raise concerns, in that it remains too heavily weighted in favour of the Bank. Greater transparency is also required where it exercises its powers of strategic management in relation to the FCA and PRA. The clarity of the relationship between the FPC and the MPC is also a concern, given that the line between monetary policy and financial stability is increasingly blurred. Further, the position of the UK within the EU has to be recognised, as the FPC's range of macro-prudential powers will ultimately depend on the parameters set at the EU level than they will on any constraints posed by Parliament or the Treasury.

Finally, the PRA veto has the potential to shape the relationship between the FCA and PRA. Even if it is never used, it is likely to affect the balance of power and relationship between the two regulators and risks making the FCA 'junior' regulator to the hefty Bank group.

#### Objectives, remits and responsibilities

The PRA's objectives have been successfully revised throughout the consultation process, with the addition of an objective to secure the appropriate degree of protection for those who are or may become insurance policyholders. However, the inclusion of future policyholders extends the duty beyond other insurance regulators and Solvency II, and raises a number of potential problems – how far into the future does the objective reach? Further, there is no corresponding protection for current and future deposit holders. The ability for the Treasury to extend the PRA's remit is welcome, although as ever, ensuring a 'fit' with EU regulation may be difficult.

The lack of an express power for the PRA to give guidance is an odd omission. By failing to embed the power in legislation, the PRA will be able to issue general guidance without consultation. This lack of transparency could lead to poor regulation and more arbitrary supervision. Furthermore, it may result in the PRA issuing what is in effect guidance through multiple means (speeches, Dear CEO letters etc), causing confusion and uncertainty.

Following widespread criticism, the FCA's objectives have been revised. However, the new strategic objective to ensure the "relevant markets work well" is nebulous and may cause disagreement. What is meant by "functioning well", for whom, and according to what economic theory? Further, it is unclear how the hierarchy of strategic and operational objectives, duties, regulatory principles and

“have regards” will interact, and be applied and weighed in practice.

It is intended that the FCA will play an important role in the promotion of competition. But very little has been said about how it will do so. The Government will review the granting of specific competition powers in five years’ time. However, shelving the discussion is unhelpful in informing the current debate, particularly given the potential tension between competition and the more interventionist approach to product regulation.

The importance of a proportionate and tailored approach by the FCA cannot be understated. The latterly added requirement for the FCA to have regard to the principle that firms should be expected to provide consumers with a level of care that is appropriate to the degree of risk involved and the capabilities of the consumers in question, is welcome, as it will provide the FCA with a clear basis on which to distinguish between retail and wholesale consumers.

Relatively little detail has been given so far in respect of the FCA’s proposed approach to prudential regulation. The FCA will need to maintain and develop its own prudential expertise and mechanisms for a broad range of firms. Clarity is also needed as to the procedures for designating firms as either FCA and/or PRA regulated, particularly in relation to what procedural safeguards will surround the designation criteria and how PRA-designable firms might move between FCA regulation and dual regulation.

It is of critical importance for the FCA’s ability to make product intervention rules to be balanced against not stifling innovation and product choice. It has perhaps been overlooked that this much publicised power is a power to make rules, not to intervene. Further, that the regulator already has powers to make product interventions. The FCA’s power to render pre-existing agreements unenforceable is highly controversial, as it is likely to cause legal certainty issues, particularly in relation to products sold in advance of the ban. As is the weakness of the “expedience” test, for the FCA to dramatically intervene by imposing temporary product intervention rules without consultation. The FCA’s powers must be seen in the wider context of European powers to intervene. The need for the FCA to manage carefully the risk of duplicative action being taken on firms is acute. Ideally, implementation of the UK rules would have been deferred until the scope of the European regime is clear.

We query whether the FCA’s power to direct a firm to withdraw or refrain from issuing misleading financial promotions and a duty to publish this action is necessary. The FSA already has powers to take action to stop misleading financial promotions and it has the discretion to publish supervisory notices, and indeed has already been doing so.

## **Enforcement**

The Bill contains a number of significant erosions into due process. The power for decisions to issue Warning/Decision Notices to be taken by a group of persons, only one of whom must be a person not directly involved in establishing the evidence, is the cause of some serious apprehension. As is the new power for the regulators to publish at their discretion without proper judicial process, the fact that a Warning Notice has been issued, together with a summary.

The limitation of the course of action available to the Upper Tribunal in the event it chooses not to uphold a regulators’ decision, except in relation to disciplinary matters and those involving third party rights, is deserving of some sympathy. However, we submit that in all cases involving the right of an individual to work in a regulated industry or in certain roles in advisers to regulated bodies, or as advisers to or as directors of issuers, and in all cases where financial penalties are imposed, the affected party should be entitled to a full hearing by an independent tribunal on the merits, so as to be compliant with EU duties and the ECHR.

Lastly, the new power for the FCA to appoint a skilled person directly, is a potentially important issue, as it is not clear what, if any rights the firm will have in respect of the appointment of the skilled person, the terms or the quality of the product.

## **Summary**

Many of the changes in the Bill are to be welcomed. However, there is still much to be done, and much will depend on how the new regulatory system is implemented, and how it interacts with the European regulatory framework. We intend that the Forum will keep the debate alive.

### 3 Coordination and balance in the new regulatory system

As is by now well known, the reforms will establish a macro-prudential regulator, the FPC, to monitor and respond to systemic risks; transfer responsibility for micro-prudential regulation to the PRA, and create a conduct and markets regulator, the FCA. The Bank of England's powers will thus be considerably enhanced: the FPC is a committee of the Bank, and the PRA is its subsidiary. In addition, though it has attracted less comment, the Bank will take on responsibility for the regulation of clearing houses and settlement systems<sup>2</sup>. This will not be performed via the PRA but as part of its central functions, along with existing regulatory responsibilities for payment systems. It is also responsible, since the Banking Act 2010, for the resolution of financial institutions.

The reforms have been introduced, in part, to address the coordination failure between the Tripartite Authorities (FSA, Treasury and the Bank) in the handling of the Northern Rock crisis. In creating the 'Triple Peak' structure, however, the reforms risk substituting one coordination problem with a whole new set of coordination issues, and in day to day issues not just at times of crisis. The powers and responsibilities of each therefore have to be clearly set out and understood, both by those within the system and by those outside it, from legislators to the public. Achieving the right balance of powers between them is also vital. Whilst the responsibilities for decision making have to be clear and mechanisms need to be in place to resolve disputes between the bodies, any suggestion that one of the regulators is of lesser importance than the others is unlikely to be beneficial to the long term working dynamics of the system.

There are three broad sets of coordination issues: the relationship of the Treasury with the different regulators, including the Bank; the relationship of the FPC with the other regulators: the PRA, FCA and the regulatory functions of the Bank for critical market infrastructure (CMI); and the relationship between the FCA and PRA, both on strategic issues and on day to day operational matters.

#### Relationship of the Treasury, the Bank and the regulators

One of the criticisms made of the existing structure is that the powers of the Treasury with respect to the Bank

were unclear, and that the Bank had an insufficient role in ensuring financial stability. It is more accurate to say that the Bank had a remit but that it did not fulfil it, focusing instead almost exclusively on meeting its inflation target. The MOU which defined the role of each of the Tripartite members clearly stated that as one of its 'core purposes' the Bank 'contributes to the maintenance of the stability of the financial system as a whole', to which end '[t]he Bank advises on the implications for UK financial stability of developments in the domestic and international markets.'<sup>3</sup>

Both issues are addressed in the Bill. The Bank's role in financial stability has been re-emphasised both in the definition of its objectives and in the creation of the FPC. The Bank's Court of Directors is charged with determining the Bank's financial stability strategy, in consultation with the FPC and the Treasury. The Treasury can thereafter issue published recommendations to the FPC, which the FPC is required to issue a public response to, but only on a 'comply or explain' basis.<sup>4</sup> The Joint Committee recommended that the Treasury be empowered to issue directions to the FPC, but these powers have been confined to crisis situations, where the Treasury can issue directions to the Bank with respect to financial assistance outside of its normal market assistance, either prospectively or retrospectively, where that assistance 'is necessary to resolve or reduce a serious threat' to the stability of the UK financial system.<sup>5</sup> Note that this is an objective test, and as such an exception to the subjective nature of most of the other duties conferred by the Bill. Whilst it may have been considered too great an intrusion on the Bank's independence to have a subjective test (in the opinion of the Treasury), it is to be hoped that the objective nature of the test means that the power is not thwarted by disputes between the Treasury and the Bank as to whether or not such a threat does exist.<sup>6</sup>

There are a number of provisions relating to the transparency of the relations between the Bank/FPC and the Treasury, though these are usually qualified by public interest exceptions, which is to be expected in this area. The FPC is to publish minutes of its meetings, subject to confidentiality requirements, and is to issue two financial stability reports a year. In order to improve communication between the Bank and the Treasury on financial stability issues, the Governor of the Bank and the Chancellor are required to meet to discuss each report, and minutes of those meetings are to be published, unless the Treasury determines publication would not be in the public interest.

However, with respect to the Bank's response to directions given to it by the Treasury in the context of financial assistance, whilst the direction has to be published the Bank is under no obligation to give a report on how it is complying or intends to comply with such a direction.<sup>7</sup> Whilst there may well be many situations where 'real time' reporting may not be appropriate, it is suggested that a reporting obligation should be imposed in this instance, particularly as public money is at stake. Such a report could be subject to the same public interest exceptions that are placed on other transparency obligations, and that reports should be published as soon as any risks to financial stability from publication have passed.

In other respects, the role of the Treasury has been strengthened with respect to the Bank, the PRA and the FCA. Following criticisms of the draft Bill there is now to be a single complaints process for both regulators and the Bank, to be approved by the Treasury. The Treasury's powers have also been strengthened with respect to the ability to require special investigations or inquiries into the operation of those persons or activities which are regulated by the PRA or FCA, though there is an odd exception in that it cannot require an inquiry into recognised investment exchanges; only the FCA can do that. It can also direct the FCA and PRA to conduct inquiries into events which arose from their own regulatory failures. Reports of such inquiries are to be published and laid before Parliament, again subject to public interest exceptions, though in this case reasons must be given to Parliament with respect to the withholding of parts of the report.<sup>8</sup> This is a welcome addition, and could avoid the situation that the FSA faced with respect to the publication of its report into supervision of the Royal Bank of Scotland.

However, there is no parallel power for the Treasury to require the Bank to conduct investigations into its own regulatory failures. This is a significant omission, for which there seems to be no obvious justification. The Bank has regulatory powers over parts of the critical infrastructure of the financial system, payments and clearing houses. Any failure in either could have significantly destabilising consequences, and there is no justification for not requiring an investigation into possible regulatory failures. It is worth noting that the willingness of the Bank to engage in sustained, and public, self-criticism for its role in the crisis stands in marked contrast to that of the FSA. The outright refusal of the Court of Directors to provide information to the Treasury Select Committee (TSC) relating to discussions at critical phases in the 2007-8 crisis is remarkable in its

obduracy and suggests that in the absence of any legal obligations to do so, the Bank is unlikely either to conduct or to publish such an investigation voluntarily.

Significant limitations also remain with respect to the internal governance structure of the Bank and the accountability of the Bank to Parliament and the Treasury, through both the Governor and the Court of Directors of the Bank. The role of the Court is unclear – whilst most of those giving evidence to the TSC inquiry in 2011, including members of the Court, were of the view that its remit was limited to reviewing the Bank's internal 'housekeeping' and budget,<sup>9</sup> the Bill now charges it with setting the Bank's financial stability policy. It seems perverse to give a weak body even more powers, suggesting that in practice it will be the Governor that sets the Bank's financial stability policy. The Court also appears to have little ability to call to account executive members of the Bank, including the Governor, nor little interest in doing so, as demonstrated by TSC report of its discussions with the Governor with respect to the Bank's role in the financial crisis and, separately, its lack of support for the external members of the Monetary Policy Committee (MPC).<sup>10</sup> As noted above, it also shows little regard for its accountability obligations to Parliament, refusing to publish reports of such discussions as took place on the grounds that it was not required to do so under Freedom of Information legislation.<sup>11</sup> Such lack of recognition of the critical public significance of its role, and thus the attendant obligations of accountability to which that role gives rise, is remarkable, and very worrying.

Moreover, as it moves into the area of macro-prudential policy, the distributional consequences of the Bank's decisions will become clearer to see, and its activities are therefore likely to become more controversial. We would therefore support proposals to reform the role of the Court of Directors quite significantly. The TSC recommended that the role of the Court should be substantially enhanced and that it should be transformed into a 'leaner and more expert Supervisory Board, with the power to conduct retrospective reviews of Bank policies and conduct'.<sup>12</sup> The Board should also be made responsible for meeting reasonable requests for information by Parliament. Its proposal to name it a 'Supervisory Board' may be too redolent of German models of corporate governance to be attractive to some, but the principle we argue that the Bank should be governed by a board, chaired by the Governor, with the current deputy directors having executive responsibility for their divisions and with a majority of independent members. It would bring the Bank in line with other powerful independent regulators

in the UK and whilst not guaranteeing that sound corporate governance would result, would create clearer lines of internal responsibility and external accountability.

### **The role of the Bank and the FPC**

The creation of the FPC results from a recognition shared by regulators at the global level that managing the systemic risks of the financial system cannot be achieved purely through the prudential regulation of individual institutions; regulators have to look at the system as a whole. The FPC's role is principally one of strategic management of the new regulatory system. Its statutory objective is to contribute to the Bank's attainment of its financial stability objective, focusing primarily on 'the identification of, monitoring of, and taking of action to remove or reduce, systemic risks with a view to protecting and enhancing the resilience of the UK financial system.'<sup>13</sup> The Bill indicates that this includes monitoring the interconnectedness of financial institutions, the distribution of risks within the system and 'unsustainable' levels of leverage, debt or credit growth. However, reflecting the tension between financial stability and macro-economic policy, the FPC is not required to act in such a way as would, in its opinion, have a significant adverse impact on the ability of the financial sector to contribute to the UK economy in the medium or long term. This is a reversal of the previous position, which was that it was required to ensure that its actions did not have such an effect, a provision which was criticised by the Joint Scrutiny Committee as too 'strong and restrictive'<sup>14</sup>.

These objectives and remits of the Bank reflect the post-crisis shift in political perception of the role of the financial services industry, and the relationship between the industry, its regulation and the real economy. It also has to have regard to issues of proportionality, transparency, and international law (which would include EU law). As noted above, it will receive written recommendations from the Treasury on how it should both understand that objective, and on how it should fulfil it, to which the FPC has to respond on a 'comply or explain' basis. However, as we suggest below, it is by the European regulators that the FPC may find itself most bounded, rather than the Treasury.

### **Membership**

The creation of the FPC has been broadly welcomed, but its constitution and composition have raised concerns, specifically that the proposed membership is

too heavily weighted towards the Bank. At present, the membership is to comprise the Governor of the Bank, the Deputy Governors, those within the Bank with executive responsibility for financial stability and regulation of CMI, the chief executives of the FCA and the PRA (an ex officio position for the Deputy Governor for Prudential Regulation), four external members appointed by the Treasury and a Treasury representative.

However, despite criticisms made by the TSC of the heavy 'Bank weighting' in the proposed composition of the FPC (and also of the MPC), provisions in respect of the FPC's governance transparency and accountability, remain largely unchanged. The TSC strongly believed that the FPC (and the MPC) should have a majority of external members in order to promote debate and creative tension to discourage group-think; the Bank suggests this would undermine the Government's purpose in giving the responsibility to the Bank in the first place. We would suggest that such fears are misplaced, and that the FPC should have a majority of external members, and that the Court of Directors, or preferably a reformed Board, should be required to ensure that such members receive adequate resources from the Bank, including information and staff, in order to perform their functions.

### **Macro-prudential tools and potential EU constraints**

The overriding objective that runs through the reforms is financial stability. That is the concern that trumps all others, and that is reflected in the powers of the FPC. The FPC is to have a range of macro-prudential powers. These are to be provided in orders made by the Treasury, which is a sensible approach as it allows for new powers to be added quickly. The Joint Committee recommended that the macro-prudential tools should be subject to enhanced parliamentary scrutiny, other than in urgent cases, and the tools being subject to a sunset clause of one parliament.<sup>15</sup> Enhancing Parliamentary scrutiny could in principle improve accountability, but as the crisis demonstrated, the flexibility and the ability to respond rapidly to unprecedented situations can mean that Parliament is in effect bypassed, with orders placed before Parliament to authorise actions which have already been taken (such powers also assume that crises will arise when Parliament is sitting).<sup>16</sup> As we saw in 2007-8, dealing with crises often requires the Treasury, Bank and the regulators to act now and authorise when possible.



However, even if Parliamentary approval is required, it is likely that the most significant constraint on the FPC's ability to act will come from the EU, not from Parliament. We have already seen disputes as to whether the UK would be able to impose higher capital requirements on UK authorised financial institutions than those stipulated in EU Directives. The extent to which the FPC, or indeed the Treasury, will be able to fashion or use particular tools is likely to depend far more on the parameters set at the EU level than they will on any constraints posed by Parliament, or indeed the Treasury.

### ***FPC's system management powers – greater transparency needed?***

The FPC can exercise its powers of strategic management principally through making recommendations to the PRA, FCA and the division of the Bank that regulates CMI. They are required to respond on a 'comply or explain' basis. In addition, if the Treasury order setting out a particular macro-prudential tool so provides, the FPC will have the power to direct the FCA and PRA to exercise that particular tool with respect to a specified class of person (though not a specified person, though in practice it the 'class' may have only one member). The Joint Committee recommended that the power of direction should include the power to direct the timing and means of the implementation of a macro-prudential tool in cases where these are likely to significantly impact the effectiveness of the tool<sup>17</sup>, but this has not been reflected in the Bill. Notwithstanding those powers, the FPC is to have regard to responsibilities of FCA and PRA (new s.9E BoEA) and is not to exercise its functions in a way that would adversely affect their ability to pursue their objectives.

Finally, and in a welcome amendment to the draft Bill, the FPC is now required to prepare and maintain a written statement of the policy it proposes to follow in relation to the exercise of its power of direction in relation to each macro-prudential measure (this would not prevent the FPC from exercising the power of direction in urgent cases, without such a statement). The Bank must publish each policy statement.

However, there is no requirement on the FCA or PRA to publish information as to compliance or otherwise with the recommendation from the FPC, or actions taken to comply with a direction. There seems little justification for this omission. Publication of such information would significantly improve the transparency of the system. It is recognised

that such actions can be sensitive, and 'real time' transparency is not always conducive to financial stability. Nonetheless, as the recommendations are generic and not specific to any particular institution, the publication of a report as to the FCA's or PRA's response need not identify individual institutions. It could also be provided post hoc, for example as part of each organisation's annual report.

### ***FPC and the MPC – should the twain meet?***

Finally, the issue arises as to the relationship between the FPC and MPC. The line between monetary policy and financial stability is increasingly blurred. When the Bank took the radical step to introduce quantitative easing, it did not need to ask, or be called upon to answer, whether it was using it as a financial stability tool or a monetary policy tool. However, by buying gilts from financial institutions, it had the effect (even if not the intention) of aiding their recapitalisation, thus clearly having consequences for financial stability. Conversely, macro-level decisions as to the amount of capital financial institutions have to set aside under capital adequacy rules, for example, have impacts on monetary policy.

The creation of separate bodies with separate memberships and procedures for monetary policy and financial stability will require the Bank in future to characterise its actions as directed at one or the other at the very point at which the line becomes hardest to draw. In the new structure, if interest rates were perceived as fuelling another credit bubble, the MPC would not have to consult the FPC before making its decisions, nor could the FPC formally request the MPC to consider the impacts on financial stability. At present, the link between the two is through the cross-membership of the Governor of the Bank of England. It may be thought that there is no need to have any greater formalisation: the minutes of meetings of both committees will be published, and communication between internal Bank officials should allow sufficient informal information flow. However, the two committees are quite differently constituted, and include non-Bank members. Informal communications between Bank officials may be sufficient for the Bank, but not those external members. It may be that informal discussions take place between the two committees. However whether they do depends on the culture of the Bank, or more particularly its Governor, and on the perceived roles and relative status of the two committees, and indeed on whether the legislation is interpreted as allowing such meetings to occur. Clearly

the remits of the two committees are different, but there is nonetheless an overlap at critical junctures. There is a real risk that the institutional structures and procedures will inhibit a fully rounded view of financial stability and its relationship with monetary policy to occur. Moreover, the FPC itself has to consider the implications of its decisions on the wider economy. It would not be helpful if certain matters were ruled by the Governor as being off the agenda of the FPC because it was felt the MPC's view or remit took precedence, and vice versa.

The Joint Committee acknowledged that how the FPC and MPC will interact is unclear, and that coordination and communication between the MPC and FPC should minimise the risk of conflict.<sup>19</sup> It recommended that the Bank's governor should inform the Court to explain how the conflict will be handled, but did not go further. However, including in the legislation the ability, even requirement, for the FPC and MPC to meet periodically, and to take joint decisions if necessary, would recognise the dual monetary and financial stability effects of a number of policies or 'tools' that the Bank can use, including some which no one has yet thought of. Moreover, it could avoid artificial and unhelpful distinctions having to be made on procedural grounds when critical matters of substance are at stake.

### Coordination between the PRA and FCA

The White Paper states that the PRA and FCA are to be separate 'centres of excellence' with separate objectives but clear need to coordinate.<sup>19</sup> Implicit in the White Paper is a distinction between what may be termed 'strategic' coordination and operational coordination, although the two are related. As the White Paper makes clear, operational matters cannot be a matter for legislation.<sup>20</sup> Legislation can put in place mechanisms to facilitate strategic coordination, but coordination on day to day operational matters has to be a matter for the agencies themselves to work out.

With respect to 'strategic' coordination, the White Paper identified three central mechanisms:

- *Statutory duty to coordinate* (includes reference to use resources of each regulator in the most efficient and economic way and that burdens imposed should be proportionate to benefits).
- *Statutory MOU*<sup>21</sup> required to set out how the duty to coordinate will be performed, with indicative list of matter to be addressed in the MOU; and a

requirement to report in their annual reports on how they have coordinated throughout the year. The TSC recommended that coordination should be set out in primary and secondary legislation, not a MOU, following concerns about the inadequacy of the MOU between the FSA, Treasury and Bank.<sup>22</sup> In practice the effectiveness of the arrangements will depend on each party's understanding of their role, and not whether they are set out in legislation. However, if the wisdom of enshrining the provisions of an MOU in primary or secondary legislation seems doubtful – seeking to use legislation to determine how public bodies coordinate in a crisis seems foolhardy. Legislation should focus on the clarity of the bodies' powers and functions.

- *Cross-membership of boards.*

There is also a general requirement to ensure that the PRA and FCA's functions are co-ordinated, notably to consult the other where actions are contemplated that could have a materially adverse effect on the other's abilities to achieve its objectives; to ensure that each obtains from the other the information that it needs in areas of common interest where the other has specialist knowledge or expertise; and that where they exercise functions with respect to common areas of interest, that each acts in accordance with the regulatory principles set out in the legislation.<sup>23</sup> The regulatory principles have also been streamlined so that each is now subject to the same obligations, which is to be welcomed.

However, the requirement that the PRA and FCA ensure that processes involving the other regulator are managed 'congruently and efficiently' has been dropped from this version of the Bill, as has the requirement to combine supervisory activities to reduce burdens on firms. The prospect of each regulator demanding separate and potentially different actions by the firm, for example with respect to the design of systems and controls, thus arises. The Joint Committee report argued that the regulators "must coordinate as far as possible to minimise the burden on dual-regulated firms".<sup>24</sup> Martin Wheatley's evidence indicated that information given to one regulator will be shared with the other so that the same information will not have to be given twice. The report also stated that while a joint rule book and a single point of contact may not be possible, the two bodies should consider other methods of reducing the burden.

The duty to coordinate is subject to a proviso that coordination does not impose a burden on the *regulators*

which is 'disproportionate to the benefits of compliance'. Whilst it is important to ensure that each regulator does not have to consult the other first before it can do anything at all, it is questionable whether it is appropriately framed. Consulting the other regulator seems unlikely to be 'disproportionate to the benefits of compliance' if the conditions for coordination are met. When could it be 'disproportionate' to consult on an action that would have a materially adverse impact on the other regulator's ability to achieve its objectives? Nonetheless, there is now an overriding duty for each to consult the other before exercising their general rule making powers,<sup>25</sup> which again streamlines the provisions and avoids some of the anomalies in the draft Bill, where for example there was no duty to consult on rules relating to recovery plans. However, this duty does not extend to waivers – an omission which should be addressed.<sup>26</sup>

There is one much more glaring omission from the duties to coordinate, however, and that is that there are no obligations on the Bank to coordinate with the FCA or PRA with respect to the exercise of its regulatory functions. As discussed further below, throughout the Bill it is frequently forgotten that the Bank is a direct regulator as well; it is not subject to the regulatory principles that apply to the FCA or PRA, and whilst it can require information from them with respect to the fulfilment of its financial stability objective, there is no equivalent to the provisions on coordination that exist between the FCA and the PRA. Though the Bank, PRA and FCA have agreed a mutual MOU on coordination, there is no obvious justification for these omissions in the legislation, which again should be addressed.

The extent to which the regulators coordinate in practice will be critical to their effectiveness and to how firms experience regulation. Whilst it is to be recognised that the FCA and PRA in particular have different objectives, the risk is that gaps will be created and that issues will simply fall between them. Ensuring effective and cooperative day to day relationships between the three regulators will thus be essential if the benefits of breaking up the regulatory structure are not to be outweighed by the costs, both direct and indirect, of fragmentation.

### **PRA veto**

The duties to consult and the MOU will be important, but what has the potential to really shape the relationship between the FCA and the PRA is the PRA veto. The veto

is a clear manifestation of the post-crisis reframing of the objectives of financial regulation: financial stability. The new powers will enable the PRA to veto any decision or action of the FCA with respect to a PRA authorised person (where the FCA is not legally required to make that decision or take that action) where the threshold condition is met.<sup>27</sup> That condition is that the PRA is of the opinion that the exercise of the power in the manner proposed may (a) threaten the stability of the UK financial system or (b) result in the failure of a PRA- authorised person in a way that would adversely affect the UK financial system.<sup>28</sup> The scope of the PRA veto has been extended in the Bill to enable it to require the FCA to refrain from exercising its insolvency powers in respect of PRA- authorised persons. The direction need not be published if publication would be contrary to the public interest, though the PRA is required to review that decision periodically.<sup>29</sup>

Like Banquo's ghost, Equitable Life haunts this part of the reforms. In that instance, as will be recalled, the FSA faced the unenviable decision of whether or not to require Equitable Life to close to new business pending the House of Lords' decision on its obligations for the guaranteed annuity policies sold, knowing that if the decision required Equitable Life to pay out on the guarantees that it would fail, but that if it closed it to new business this could also have a materially adverse impact on its financial situation and the outcome of the case was still uncertain. One of the key questions in crafting the new reforms is how such an issue would be decided, and by which regulator, should a similar situation arise in the future. In such a situation, if the FCA were to decide, for example, that a firm should no longer be authorised to conduct a certain activity but the PRA was of the view that ceasing that line of business could result in a failure which it could not manage through the resolution process, the PRA can veto the decision.

In practice, the threshold for the exercise of the veto is high, and even if those conditions were reached it is unlikely that it would ever be used; informal discussions and understandings would probably lead to the same result. But, there are situations when it could be used: if the relationship between the PRA and FCA is such that informal discussions are not enough to persuade the FCA not to act, or if the FCA fears that it would be opening itself up to an action in judicial review if it did not make the decision, and so needs the legal protection that the PRA veto would give it. Even if never used, however, it is likely to affect the balance of power and the relationship between the two. It will be difficult to dispel the notion

that consumers and markets are less important than the critical job being performed by the Bank. Concerns to protect particular groups of consumers, for example will be trumped by broader concerns for financial stability. Given that it is taxpayers that fund bail outs, this is probably the rational solution. But it does risk making the FCA the 'junior' regulator to the hefty Bank group.<sup>30</sup>

## 4 Objectives, remits and responsibilities

The objectives of the new bodies have undergone a number of iterations throughout the consultation process. This section looks in turn at the Bank's regulatory role, the PRA, and the FCA, focusing in particular on the critical issue of enforcement.

### Bank of England as a regulator – do we need to create another (mini) peak?

The Bank of England is also to gain additional regulatory responsibilities for CMI (clearing, settlement and payment systems) which it will perform directly from its central secretariat. The regulation of CMI has only lately begun to receive the same attention as other parts of the system. The proposal is that the FCA will regulate investment exchanges, and the Bank will regulate clearing houses, along with payment systems and settlement systems. However, the allocation of regulatory responsibilities to the Bank has been done in a piecemeal fashion, and the result is that gaps and anomalies are created with respect to the powers and accountability arrangements that apply in each case. Moreover, it seems to be generally forgotten throughout the Bill that the Bank is to be a regulator at all.

The Bank already has responsibility for regulating payment systems under the 2009 Banking Act. This gave the Bank powers which are those of a 'normal' regulator for the first time: to issue principles (subject to Treasury approval), to issue a code of practice, to issue directions, to appoint an external expert's report, and to impose sanctions: fine, closure of the payment system, and management disqualification.<sup>31</sup> These powers have been slightly amended in the Bill, but it has not changed the position under the 2009 Act that there are no duties on the Bank to consult

before issuing principles or a code of practice, for example, as there are for the PRA or FCA.

Under the new proposals, the Bank will also take on regulation of clearing houses. Part XVIII of the amended Financial Services and Markets Act essentially carves up the FSMA 2000 provisions on recognised investment exchanges (RIEs) and recognised clearing houses (RCHs), re-allocating responsibilities between the Bank and the FCA, and streamlining the procedures for issuing directions.<sup>32</sup> However, anomalies remain between the FCA's powers with respect to RIEs and the Bank's powers with respect to RCHs, and between the Bank's powers and responsibilities in regulating payment systems and in regulating clearing houses. First, with respect to RIEs, the FCA has powers with regards to the control of the RIEs, but the Bank has no parallel powers with respect to control of an RCH. Second, with respect to the Bank's powers *vis-à-vis* payment systems and clearing houses, there are quite separate rule making procedures for each, and separate sets of disciplinary powers. The rationale for this is unclear, and at the very least the Bank should have the same set of powers and consultation responsibilities with respect to each.

The accountability arrangements for the way in which the Bank exercises its regulatory powers are also different from those applying to the FCA and PRA. The Bank is under no obligation to conduct an inquiry into its regulatory activities with respect to clearing, payment or settlement, in contrast to the obligations on the FCA and PRA (introduced as a consequence of the recent experience of the FSA's report on RBS). Nor is the Bank subject to the general regulatory principles nor, it should be noted, to the principles of good corporate governance, both of which apply to the FCA and PRA (and indeed to any other UK regulatory agencies). With respect to the regulation of CMI, therefore, there is an asymmetry in the powers and accountability obligations of the Bank in comparison with the PRA and FCA, and the Bank's own powers with respect to different bodies. At the least these anomalies should be brought into line.

Moreover, there seems little justification for splitting the prudential regulation of CMI between two regulators. A better approach would be to give responsibilities for the financial soundness of CMI to the PRA or to a separate subsidiary of the Bank, or at least to its recently created Payments and Infrastructure Division, and to ensure the Division has clear and transparent lines of reporting and accountability.

## PRA

The PRA's objectives have been successively revised throughout the consultation process. Following concerns that they did not focus sufficiently on the PRA's responsibilities for insurance companies, there are now two objectives: the general objective, which is the PRA's responsibility for the safety and soundness of PRA- authorised persons, and the insurance objective, which is to secure the appropriate degree of protection for those who are or may become policyholders.<sup>33</sup> Note that the Joint Committee recommended that the PRA should have a secondary objective to reduce potential costs of failure to the Financial Services Compensation Scheme, taxpayer funds and customers, given that the legislation is drafted such that financial stability is its primary concern.<sup>34</sup> The Bill provides for the possibility for the scope of the PRA's jurisdiction to be changed by order from the Treasury.<sup>35</sup> This 'extendable reach' provision was included in the February 2011 consultation in recognition that there may be a need for the PRA's remit to be extended, in particular to investment banks. As the crisis demonstrated, institutions which were thought to be relatively marginal to the financial system can very quickly become systemically important because of their interconnectedness to other, more obviously systemic institutions or because their failure prompts a rapid loss of confidence. This ability to extend the PRA's remit brings a welcome element of dynamism to the system, though as ever ensuring a 'fit' with EU regulation may be difficult. However, the political message also needs to be given that the boundaries of the PRA's jurisdiction are not coterminous with the boundaries of the taxpayers' guarantee.

### **Insurance objective**

The addition of the insurance objective was to address the criticism that the previous draft of PRA's objectives did not fit well with its responsibilities for the prudential regulation of insurance companies. In specifying the objective to include future policy holders, however, the Bill extends the duty beyond that of other insurance regulators, whose objectives focus on protection of current policy holders, and beyond the objectives of Solvency II.

Whilst the intention may be to focus regulators' minds on ensuring that the business is a going concern, the specification to protect future policy holders raises a number of potential problems. How far into the future does

the objective reach? Is it to protect those who may become policy holders in one year, five years, ten years?

There is also a risk that there will be confusion with the FCA's objectives and remit for regulating conduct of firms, for example with respect to misselling of products. The sales process, after all, is directed at those who may become policy holders.

Furthermore, there is no parallel requirement to protect current and future deposit holders. It may be countered that their interests are covered in the general financial stability objective. However the stability of the system as a whole is not the same as the stability of a particular institution. The key principle which is repeatedly articulated in the White Paper and throughout the reforms is that financial stability does not mean ensuring that each individual institution continues as a going concern. The 'non-zero' failure principle, to be enshrined in legislation,<sup>36</sup> is that failure of a firm is not a failure of regulation, as long as that failure can be resolved without any materially adverse impact on the rest of the system. Ensuring financial stability is therefore not the same as ensuring that there should be no material adverse impact on depositors. Neither current nor future deposit holders are identified for specific attention, yet policy holders of insurance policies are. There is therefore the appearance, at least, of an asymmetry of protection between the two groups of consumers.

### **With-profits policies**

The draft Bill also provided that the PRA was to be responsible for 'contributing to the securing of an appropriate degree of protection for the reasonable expectations of policyholders as to the distribution of surplus under with-profits policies.'<sup>37</sup> The Joint Committee noted the lack of legal certainty and accountability which may result from the definition of "reasonable expectations" and recommended that the Bill be redrafted to achieve the same end without using these words.<sup>38</sup> It also raised issues of the distribution of responsibility between PRA and FCA for with-profits policies, as there are reasons why policy holders' reasonable expectations may not be met other than lack of financial soundness. For example, this could arise from excessive undisclosed costs or the way firms choose to exercise their discretion in attributing profits over the course of the policy and between different groups of policy holders. Some of these may more properly be seen as conduct issues and therefore the responsibility of the FCA.

The Bill now provides that the PRA's responsibility in relation to with-profits policies includes the securing of "an appropriate degree of protection for those who are or may become policyholders in relation to decisions by insurers relating to the making of payments under with-profits policies at the discretion of the insurer (including decisions affecting the amount, timing or distribution of such payments or the entitlement to future payments)". This makes the obligation clearer, though the specification with respect to this aspect of the PRA's remit seems at odds with the otherwise high-level definitions of objectives within the Bill.

Moreover, the Bill has amended the definition of "with-profits policy" to include any contract of insurance under which the policyholder is eligible to receive payments at the discretion of the insurer. No explanation for this change is given. This may extend the category more broadly than intended. Even if there are no products which at present grant eligibility to receive additional payments (other than those currently understood to fall within the "with-profits" category), it seems to us that this would have the effect of impeding future product innovation for little apparent benefit.

### ***Powers of the PRA***

The rule making powers of the PRA are in line with those of the FCA, with a notable exception.<sup>39</sup> That is that the PRA has no legal power to give guidance. This is an odd omission. The power is confined to the FCA, though unlike the FSA, it will not have to consult before issuing guidance or perform a cost-benefit analysis.<sup>40</sup> Although this appears to be a relaxation in accountability requirements, in fact it is to be welcomed. Having the same procedures for issuing rules or guidance had two ill-effects: it led to the FSA 'creatively complying' with the legislation by issuing guidance but calling it something else (for example 'Dear CEO' letters), and to firms thinking that formal guidance was the same as a rule.

Given that there are no procedural requirements to issuing guidance other than the need to notify the Treasury, and given that no regulator in practice regulates without guidance, the legislation prompts the question as to why the PRA has not been given this power. Moreover, by giving the power explicitly to the FCA but not the PRA, it prompts the question as to whether the PRA is by implication barred from giving guidance. The response appears to be that as the PRA will be a 'judgement-led regulator' who has very

close, tailored and bespoke relationships with the individual institutions it regulates, it will not need the tools of a 'mass-market' regulator such as the FCA.

This seems an extraordinarily misguided attitude. First, it is not the case that the PRA's remit will consist exclusively of a few large financial institutions to whom it will be sufficient to have published rules and then informal guidance given on an individualised basis ('guidance with a small g'). Its remit is not the same as it was pre-1997, and the notion that it can adopt that same attitude and approach to banking supervision as it did then is simply not acceptable (even leaving the small matter of the Bank's complete failure to supervise Barings Bank politely on one side). The PRA will have a large number of firms in similar positions to whom it may well want to give published, generic guidance. The most obvious group are credit unions, but guidance may well be an efficient mechanism for the PRA to communicate with other groups in its regulatory constituency, including insurance companies, building societies and those simply too small to deserve the resource-intensive levels of individual supervision that high-impact firms will be given. It is far from clear why the PRA will be so different from any other supervisor that it will not need to issue published guidance. Australian Prudential Regulation Authority, for example, implemented the whole of Basel II through guidance.

Secondly, giving generic, published guidance is not only a more effective way to regulate than having to communicate the same thing to each firm individually, it is more transparent. Anyone familiar with regulation knows that there are rules in the books, and then there is what happens on the ground. Rules are interpreted and adapted to different circumstances. Over time, particular understandings develop, but unless these are formalised and published as guidance, the system is opaque, risks of inconsistency arise and a gap between the rule and the way it is in fact interpreted grows unnoticed.

However, even without the clear statutory power to give 'guidance with a big G', it might be argued that there is no need for an express power for the PRA to give general guidance (even though such a power is given to FCA). However, by failing to put the power on an express statutory footing, the legislation enables the PRA to issue general guidance (or indeed to regulate on the basis of unpublished internal policy and guidance) that is not subject to any duties of transparency. Furthermore, it may result in the PRA issuing what is in effect guidance through multiple means,

including speeches, 'frequently asked questions', or Dear CEO letters. Unless the regulator is very disciplined, the means by which guidance is given can multiply, as they did under FSA, causing confusion and uncertainty for firms. This lack of transparency and consultation could lead to poor regulation and more arbitrary supervision.

## Financial Conduct Authority

### Objectives

Following criticism by the Independent Commission on Banking (ICB), the Joint Committee and the TSC, the Government has revised the FCA's objectives.

It had previously been proposed that the FCA would have a strategic objective to protect and enhance confidence in the UK financial system. This objective had attracted criticism, given that confidence can at times be misplaced, and that it did not focus on the FCA's intended purpose, which is to ensure that business is conducted in a way that advances the interests of users and participants. The Joint Committee recommended that the strategic objective should be amended to promoting "fair, efficient and transparent financial services markets that work well for users".<sup>41</sup> The TSC went even further by suggesting<sup>42</sup> that the strategic objective should be altogether removed, given that the substance is already embodied by the three operational objectives<sup>43</sup>, being to: secure an appropriate degree of protection for consumers, promote efficiency and choice (now changed to promoting effective competition in the interests of consumers – see below), and ensure the integrity of the market.

In line with the Joint Committee's recommendation, the FCA will now have a strategic objective to ensure that "the relevant markets function well". There is likely to be considerable uncertainty, and indeed disagreement, as to what is meant by "functioning well". Functioning well for whom and according to what economic theory? Further, whilst the market can appear to function well in the short-term, this could lead to detrimental consequences in the long-run.

The FCA will have regard to a list of factors in interpreting the operational objectives. It must also take into account the same set of regulatory principles as the PRA and the importance of taking action to minimise financial crime.<sup>44</sup> It will also have a duty to discharge its general functions, in so far as compatible with its objectives, in a way which

promotes competition.<sup>45</sup> As currently drafted, the hierarchy of strategic and operational objectives, duties, regulatory principles and "have regards" is far from clear. There is little clarity about how these will interact, and be applied and weighed in practice. It would be helpful to have some indication of the basis on which competing interests are to be assessed and weighed, possibly along the same lines as are set out in section 300A FSMA. Ideally, the objectives, duties, regulatory principles and "have regards" should be simplified in order to ensure clarity of purpose.

### Competition

It is envisaged that the FCA will play an important role in the promotion of competition, so as to place "competition concerns at the heart of the new conduct regime".<sup>46</sup> After publication of the draft legislation (which provided for a duty to discharge the FCA's general functions in a way which promotes competition), competition was placed even more in the spotlight by the ICB, Joint Committee and TSC. In line with recommendations for the role in promoting competition to be given more prominence, the FCA now has a new operational objective to promote "effective competition in the interests of consumers". This has replaced the original "efficiency and choice" operational objective and the FCA will still be required to discharge its general functions in a way which promotes competition. The Government has stopped short of the TSC's more radical recommendation which was to elevate the FCA's competition remit to a primary objective.<sup>47</sup>

Very little has been said about how the FCA will fulfil its "wide-ranging competition mandate"<sup>48</sup>. The White Paper stated that the paper on the FCA's approach to regulation would set out in more detail how the approach to competition would be operationalised.<sup>49</sup> However, scant detail was provided. The Joint Committee report concluded that the FCA will need greater competition powers.<sup>50</sup> However, it stopped short of articulating exactly what they should be. The TSC merely postponed the debate by recommending that specific competition powers should be reconsidered once the FCA has begun operating.<sup>51</sup> The Government has now said that this issue should be reviewed in five years' time.<sup>52</sup> Shelving the discussion is arguably unhelpful in informing the current debate as to how the FCA should interpret and fulfil its competition duty, particularly given the potential tension between competition and the promise of a more interventionist approach to product regulation.

The legislation now sets out the factors the FCA will consider when determining what constitutes effective competition.<sup>53</sup> This is a positive development, however more clarity is required. For example, would considerations of financial stability take priority over competition where these may conflict? The fact that there was vibrant but unsustainably risky competition in the domestic mortgage market prior to the Northern Rock collapse illustrates the need for clarity on this point.

### **Approach**

The White Paper confirms the need for a more proactive approach to conduct regulation with a clear focus on consumer outcomes.<sup>54</sup> It also specifically endorses the progress made recently by the FSA in adopting a more pre-emptive and intrusive approach to conduct regulation.<sup>55</sup> The importance of a proportionate and tailored approach to regulation cannot be understated, and a less interventionist approach will be warranted in respect of professional and sophisticated market participants. As such, the TSC's recommendation that greater thought should be given to more explicitly tailoring the FCA's approach and powers to retail financial services, services for professional clients and wholesale regulated activities,<sup>56</sup> was very welcome.

The Bill also now requires the FCA to have regard to the general principle that firms should be expected to provide consumers with a level of care that is appropriate to the degree of risk involved and the capabilities of the consumers in question.<sup>57</sup> This is welcome in so far as it will provide the FCA with a clear basis on which to distinguish between retail and wholesale consumers, and is particularly helpful given that the Bill provides for a universal definition of consumer which does not differentiate between different types of consumer. There have, of course, been several issues in respect of wholesale products which have been sold, some way along the distribution chain, to persons, such as local authorities, to whose profile the products may not have had the optimal alignment, with consequent retail impacts, and we note that the MiFID review is considering a revised classification for such authorities. A fuller iteration would be welcome of the kind of retail impacts that it is envisaged would warrant a more intrusive approach to the conduct of wholesale activities. Moreover it is not clear what damage the concept of a 'level of care appropriate to risk involved' does to the concept of customer responsibility. Is the implication now that it should be impossible for retail consumers to purchase certain products without a duty of

care being imposed on the firm selling the product no matter how clearly the risks are explained?

The FCA will also have prudential responsibility for non-PRA regulated firms. Clearly, it will be necessary for the FCA to maintain its own prudential expertise, and to develop appropriate prudential mechanisms for a broad range of firms. The assurance that the FCA will tailor its approach and the use of its regulatory tools to the particular risks in the sectors, firms and products which it regulates, is welcome, but as yet relatively little detail has been produced in respect of the FCA's proposed approach to prudential regulation.

Finally, clarity is also needed as to the procedures for designating firms as either FCA and/or PRA regulated. Whilst the designation of significant investment firms that could pose significant risks to financial stability will be a matter for the PRA, clearly a number of FCA regulated firms will fall within the category of firms that could be PRA-designated. At present, it is not clear precisely what procedural safeguards will surround the designation criteria, nor how PRA-designable firms might move between FCA regulation and dual regulation.

### **Product intervention**

The draft legislation provides a broad express power for the FCA to make product intervention rules, so as to enable it to intervene in banning products, or impose restrictions on features of products, quickly, when it considers that a product or product feature is likely to result in significant consumer detriment.<sup>58</sup> The Government believes that this is a "powerful" tool, however its expectation is that it will only be used where it is appropriate and proportionate, and where it will provide clarity to consumers and firms.<sup>59</sup> It is of critical importance for the legislators to balance the ability of the FCA to take action, whilst not stifling innovation and product choice.

The FCA's more proactive and intrusive approach to the regulation of products is not currently intended to constitute any form of widespread pre-approval of products. However, pre-vetting may ultimately form part of the regulatory machine should the TSC's recommendation, that the FCA conduct a review of the merits and costs of a pre-approval scheme for simple financial products,<sup>60</sup> be taken forward. Regardless of whether such a system is implemented, there remains some risk that consumers may interpret the fact that the regulator does not intervene as a form of



tacit approval or endorsement of those products. This risk will become more prevalent should the use of the product intervention power become widespread. This is a moral hazard that the FCA will need to manage on an on-going basis through its communications.

An important point to note about this much heralded power, is that it is a power to make rules. Not a power to intervene. On one view, the fact that the FCA is being granted a specific rule making power is a positive development: these rules will be of general application across categories of products and firms, rather than being targeted at individual firms, thus ensuring a level playing field in the market.

It has perhaps been somewhat overlooked in the debate that the FSA already has powers to make product interventions under its existing powers. Pursuant to section 45 FSMA, the regulator can, for example, impose requirements on products, mandate minimum standards, restrict sales to certain classes of consumers, potentially block a product launch or stop an existing product from volume sales. The FSA's existing general rule making power is arguably wide enough to enable the FSA to make rules regulating products. This begs the question as to whether it is necessary to create a specific product intervention power of the kind proposed and whether any concerns should be better dealt with through greater communication between the FCA and firms.

The key change going forward is that contraventions of the new product intervention rules may render pre-existing agreements unenforceable, if the particular rules stipulate that such consequence should ensue.<sup>61</sup> If the rules are drawn at a high level of generality, difficulties in terms of legal certainty are likely to ensue. This uncertainty is likely to be particularly problematic in relation to products sold in advance of the ban, and in relation to existing liabilities and responsibilities of firms within the distribution chain. Further, the validity of agreements in the wholesale markets may also be affected, given the broadening of the definition of "consumer" to include some wholesale consumers, such as investment banks. It will be crucial for the FCA to exercise these powers sparingly, and once exercised, for the rules to be drafted with sufficient detail, specificity and clarity.

Much will depend in practice on how the circumstances for the exercise of this power are defined. We urge the legislators to take on board the TSC's recommendation that firms should be given clear guidance on when the powers will be exercised.<sup>62</sup> No detail has been provided to date

as to which products or features will be targeted. Defining which products or features will be targeted will be critical, in particularly where products are packaged or embedded in other products. For example, if a banned product is embedded in a UCIS fund, what will the effect of the ban be? Will the UCIS be banned entirely? Or would the fund be prohibited in investing in the particular product?

Controversially, the draft legislation permits the FCA not to consult in the case of the imposition of a temporary ban, which could last for up to 12 months, in circumstances not merely in an emergency, but where the regulator merely considers this to be "expedient".<sup>63</sup> Expedience is far too weak a test for such dramatic intervention and is not sufficiently clear why the FCA should not be required to consult on the formalisation of a temporary ban within a significantly short timeframe.

The FCA's ability to intervene in this sphere must be seen in the wider context of the European agenda. Product intervention powers have been proposed in the review of MiFID, in that the European Securities and Markets Authority (ESMA) will have the power temporarily to ban or restrict specific products that threaten investor protection, the orderly functioning of markets, or financial stability. ESMA will also have the power to step in if national regulators fail to take action adequately to address these threats. It is imperative that the Government ensures that the FCA's product intervention rules are fully aligned with the powers of the European regulators, so as to reduce concerns as to regulatory arbitrage. Equally important will be for the FCA to manage carefully the risk of duplicative action being taken on firms. Ideally, implementation of the UK rules would be deferred until the scope of the European regime is clear.

### ***Financial promotions***

Another proposed tool in the FCA's family of powers will be its ability to direct a firm to withdraw or refrain from issuing misleading financial promotions with immediate effect, and a duty to publish this action.<sup>64</sup> The FSA already has powers to take action to stop misleading financial promotions and it has the discretion to publish supervisory notices, and indeed has already been doing so, pursuant to section 45 FSMA. Again, we query whether this new power is necessary. If the objective is to increase transparency, arguably the FCA could publish periodic anonymous data detailing the number of financial promotions referred, reviewed and directed to be withdrawn, with reference to

product types. Indeed the FSA has previously published useful examples of the type of problems with financial promotions that have caused them to intervene.

A crucial point which has been overlooked is that the new powers could in fact be more limiting than the FSA's current powers. Section 45 does not require a breach to be established, whereas, in order for a direction to be issued under the new powers, a breach of the financial promotion rules will need to have taken place.

One particular point of serious concern is that the draft legislation currently *requires* the FCA to publish information about a direction, even if it decides to revoke the direction after hearing representations by the authorised person. This seems fundamentally unfair and substantially beyond that necessary to protect consumers from misleading promotions. Whilst it is helpful that the White Paper suggests that the publicity may include a "fair summary of the firm's representations where it contests the direction"<sup>65</sup>, this concession should be mandatory and embedded in the legislation.

## **5** Enforcement process

It is intended that the FCA will take up the FSA's baton in order to build on the "credible deterrence" approach, continuing to display increasing confidence in using the available statutory powers, and bringing more enforcement cases. Whilst the FCA and PRA will have equivalent investigatory and enforcement powers, there is recognition that the FCA will be the enforcement powerhouse and that enforcement action by the PRA will be relatively rare in comparison. Indeed it would seem more appropriate for issues that the PRA encounters to be resolved through the supervisory process, as opposed to through enforcement, particularly in relation to judgement-based prudential issues.

There are still significant issues relating to enforcement which need to be addressed. In our first discussion paper we commented on the sense that regulators may have tired of due process, and queried whether there will be an attempt to "streamline" the enforcement process to enable the regulators to deliver public enforcement action more speedily. These concerns remain unabated, for the reasons we discuss below.

### **Decision making process – the beginning of the end of the Regulatory Decisions Committee?**

The proposal to allow decisions to issue Warning/Decision Notices to be taken by a group of persons, only one of whom must be a person not directly involved in establishing the evidence, is the cause of some apprehension. It is potentially a significant erosion to the existing safeguard that enforcement decisions should be taken by those who are not directly involved in establishing the evidence. The need for a clear separation between those who investigate and those who determine whether sanctions should be imposed is fundamental in ensuring that the decision making process operates in an effective, efficient and demonstrably fair manner. This is so, particularly in light of the proposal to significantly diminish the Upper Tribunal's remit in non-disciplinary matters, as discussed below. Despite the significance of this legislative amendment, it was not mentioned, nor discussed in the White Paper, and as a result has perhaps not attracted the discussion and focus it clearly deserves.

### **Reduction of period for responding to Warning Notices – an attempt to streamline the enforcement process?**

Another erosion into due process is arguably evident from the proposal to reduce the time period for making representations in response to Warning Notices, from a maximum of 28 days to 14 days.<sup>66</sup> Whilst it may be the case that in certain straightforward cases involving breach of threshold conditions, a minimum notice period of 14 days may be adequate, the trend in many enforcement cases is towards longer investigations and voluminous document requests (and the period for bringing action against individuals was recently extended to three years in the 2010 Act). It would be reasonable for the regulator's policies and procedures to recognise that, in the majority of disciplinary cases, where the investigation and evidence gathering may have taken several years, a respondent will need considerably more than 14 days to review and assimilate the material on which the regulator has relied.

### **Early publication of enforcement action – a move towards US style enforcement?**

The most concerning proposal with regard to enforcement is the intention to empower the FCA and PRA, at their discretion, to publish the fact that a Warning Notice has

been issued, together with a summary of the contents of the notice.<sup>67</sup> This raises significant concerns on several grounds.

The adverse impacts of so-called “early” publication of information about Warning Notices, is unlikely to be justified by the perceived benefits. Arguably the stated aim can be achieved through the disclosure of information that identifies key matters of concern to the regulator, but which does not identify the firm or individual under investigation. Such an approach would provide sufficient information to the regulated sector and the public at large about the issues of concern without the same adverse impacts, and would maintain appropriate due process safeguards for the disciplinary process. Firms can be made aware of behaviour deemed to be unacceptable through the publication of ‘soft guidance’ or anonymised public statements, speeches, Dear CEO letters and examples of good and bad practices. Speeches and consumer alerts can be, and are already, used to warn consumers of specific issues.

Publication at the Warning Notice stage will not in fact achieve the stated aim of highlighting potential issues to the market about behaviours the regulator considers unacceptable at a particularly *early* stage. The time within which the regulator may take action – the beginning of proceedings by the giving of a Warning Notice – against individuals was recently extended from two to three years by the Financial Services Act 2010. There are likely to be many instances where the FSA has issued Warning Notices against individuals after lengthy investigations, very close to the expiry of the period for commencing proceedings. The FSA’s Annual Report for 2009/2010 noted that “even in enforcement, timescales are extended; case investigation and preparation takes time, and is only possible if we have first invested in supervisory and enforcement resources; the demonstrable successes of the last year build on two previous years of investment and preparation”. The Enforcement Performance Report alludes to the “strong message about the length of time it had taken to progress some enforcement investigations” received in its feedback from firms. It is therefore plain that publication at the Warning Notice stage is most unlikely to deliver warnings to consumers or updates to firms in any timely fashion.

Publication of the summary of a Warning Notice will amount to a *de facto* public censure, but without proper judicial process, and at a stage where the enforcement team’s case may be wholly untested even before the FSA’s own internal decision makers. Such censure is a disciplinary

tool and should be used only in accordance with due process, including the right of the firm concerned to make representations and, if the FSA should decide to proceed with the public censure, a reasoned decision, which the person under investigation is entitled to refer to the Upper Tribunal for review.

Warning Notices are qualitatively different from Decision Notices, and the latter are often very different from the initial Warning Notice. Whereas the Decision Notice represents the FSA’s concluded view of the evidence, the person under investigation having had an opportunity to present their case through an exchange of written and oral representations, the threshold for issuing a Warning Notice is low. Further, it does not require the regulator to assess the likely success of the enforcement action, which criminal prosecutors are required to do, but merely whether the material is adequate to support this first step initiating the enforcement process. The firm or individual may not have had any opportunity to make representations in respect of the FSA’s factual account, let alone its conclusions.

The FSA’s Enforcement Performance Account suggests that under the scheme now proposed, 30% of individuals/firms would be at risk of suffering reputational damage as a result of the publication of Warning Notices, even though they were not ultimately the subject of an adverse public disciplinary sanction. Concerns as to reputational damage were also highlighted by the TSC and it has sensibly advised the Government to continue to consult on this power.<sup>68</sup> US research suggests that the announcement of legal enforcement actions have a negative effect on share price, and more importantly, that pending cases have larger short-term negative impacts than cases of a similar nature with known outcomes, possibly due to high levels of uncertainty.<sup>69</sup> The initial detriment caused will not in any way be compensated for by the publication of a notice of discontinuance long after the initial Warning Notice.

The filing and publication of contested complaints by regulators before they have been adjudicated upon is a feature of a number of other regimes (both here in the UK and in other jurisdictions, notably the US). It is easy to point to transparency as a self-evident good. However, there is no evidence that regimes with more aggressive enforcement regimes have fared any better in managing risks to consumers or markets. Moreover, in many of the other regulatory and law enforcement regimes in which publicity is given to the filing of a complaint the regulator or enforcement agency does not have the power to make

determinations or impose punitive sanctions itself – only to make a complaint which must then be decided upon in an independent court or tribunal at which the defendant has the right to a full, public trial. In contrast, the disciplinary process under the FSMA is an administrative process of adjudication before a regulatory body. It is therefore inappropriate to give early publicity to allegations that are not being made before a court or tribunal but by one arm of a regulator that has yet to determine for itself whether the allegations are substantiated or not. Only once the regulator has reached a concluded view should the matter become public when it may be contested before a public tribunal.

Careful consideration is needed as to the impact that the proposed publication of Warning Notices will have on the relationship between regulators and regulated firms. It is likely to lead to a much more adversarial and litigious regulatory system. This may be the policy objective, but it sits uneasily with notions of more “judgement-led” regulation or with regulation on the basis of broadly stated high level principles which leave considerable discretion as to how they are applied. Such approaches to regulation call for a high degree of openness in the communications that take place between regulated firms and their regulators. If allegations of breach can be published before any fair process of representation or dialogue has taken place, then this is liable to have a chilling effect on the supervisory process and the rules on which such allegations may be based will need to be capable of much more certain interpretation.

More importantly, there is a real risk that the industry and ultimately the public will lose trust and confidence in the fairness and integrity of the regulators’ investigations and enforcement processes. The proposed new legislative framework provides no mechanism to give assurance or accountability for the quality and accuracy of regulators’ investigation findings prior to their publication in a Warning Notice. It is not uncommon for FSA Warning Notices to contain allegations the substance of which has not been put to the individual or firm concerned during the course of the investigation. The opportunity that exists under the current regime for a firm or individual to obtain a fair hearing of their representations before damaging findings of misconduct are published is a key protection against the risk of poor investigative work. Moreover, if (as currently happens in a significant number of cases) the FCA or the PRA subsequently decide not to proceed with their action, there is no requirement on them to publish any reasoned

explanation as to why the original findings have not been upheld, and the publication of a notice of discontinuance will inevitably receive less media attention than the initial publication of information about the Warning Notice.

Having findings subject to challenge by the person who is under investigation is not only required as a matter of fairness, it helps the decision maker reach better quality findings and make better decisions. No system of professional regulation can work effectively in the long run without the confidence and active cooperation of the profession that is being regulated.

The fact that the provision is framed in terms of a discretionary power rather than a duty is welcome. However, we query whether the safeguards are sufficiently adequate: section 391(6) would prevent the regulator from publishing the information if, in the opinion of the regulator, publication would be “unfair” to the person concerned, yet section 391(1)(c) confers a discretion to publish. It is not clear on what basis “unfairness” is to be judged. Early publication of the information at this stage would always arguably be “unfair”, absent the consent of the person concerned.

The Bill contains a safeguard in that the regulator must consult the persons to whom the notice is given before publishing such information about the matter as it considers appropriate.<sup>70</sup> The inclusion of this critical safeguard is welcome, notwithstanding objections from the Joint Committee and FSA which called for it to be removed from the draft Bill.<sup>71</sup> However, it should be noted that there will be practical challenges in responding to consultation. At that stage of the process, the material (often very voluminous indeed) on which the regulator bases its case will not have been furnished to the persons concerned. This means that they will be handicapped in responding to the consultation, and particularly in identifying and correcting factual errors, and thus unable properly to challenge the regulator’s interpretation; they will also be constrained by section 391(1)(b) in giving any public response to the details published.

### **Rights to challenge regulatory decisions**

The Government’s proposal to limit the course of action available to the Upper Tribunal in the event it chooses not to uphold a regulators’ decision, except in relation to disciplinary matters and those involving third party rights, is

deserving of some sympathy.<sup>72</sup> A full *de novo* hearing before the Upper Tribunal may not be the most appropriate means of reviewing some of the most technical judgment-based supervisory decisions taken by the PRA, specifically in relation to the maintenance and adjustment of appropriate levels of capital and liquidity to be held by systemically significant firms. It may be that a committee of experts, or possibly senior level PRA staff with appropriate expertise but not involved in the initial decision-making, might provide a more appropriate forum for review of the proposed action in such cases, with a right to appeal to the Tribunal on limited grounds.

However, in all cases involving the right of an individual to work in a regulated industry or in certain roles in advisers to regulated bodies, or as advisers to or as directors of issuers, and in all cases where financial penalties are imposed, the affected party should be entitled to a full hearing by an independent tribunal on the merits so as to be compliant with EU duties and the ECHR. This is all the more essential if there is to be no requirements imposed for the proper separation of enforcement and decision-taking within the legislation.

The FSA recognises that where a regulator is committed to taking forward difficult and challenging cases, it is inevitable that, in some of those, the Tribunal will reach a different conclusion as to the facts and the resulting sanction.<sup>73</sup> In September 2011, the Upper Tribunal disagreed with the FSA's decision to fine and prohibit Mr Geddis, finding that his actions had demonstrated a lack of care resulting in a disorderly market on a single occasion, in a manner which he would never repeat and that he remained fit and proper. Under the proposals mooted in the draft Bill, the Upper Tribunal would have been entitled to make those factual findings, and could have directed a censure rather than the fine proposed by the FSA. However, it would not have been able to make any direction in relation to the ban, and would simply have had to remit the matter to the FCA to reconsider and reach a decision in accordance with those findings.

### Skilled persons' reports

There is a new power for the FCA/PRA to appoint a skilled person to provide a report in respect of any matter themselves, in addition to the existing power to require the person concerned to commission the report.<sup>74</sup> It is clear that the FSA envisages that skilled persons' reports will form an increasing part of its risk assessment framework

when it becomes the FCA. In the past, although the firm concerned has had to pay for the report, it is also the person appointing the skilled person and this contractual relationship has given it some degree of control over the process. Under the new power, the FCA will not only be able to appoint the skilled person directly, but will also be able to make rules requiring the person concerned to pay the expenses incurred by the regulator as a fee. This is potentially a very significant issue, as it is not clear what, if any, rights the person concerned will have in respect of the appointment of the skilled person, the terms of that appointment, or the quality of the product. Particularly in circumstances where the costs of these reports can run to millions of pounds, safeguards should be put in place to ensure that the regulator has some accountability for the work that it effectively outsources (at the firm's expense) in this way, since statutory immunity will protect the regulators in respect of the negligent exercise of this power.

The Government's original proposal for the FCA to be given the power to require the provision of reports by skilled persons on issuers, sponsors and primary information providers, *and* also against the current and former directors of such issuers, sponsors and primary information providers, has not been taken forward. This is a very welcome development, given that this would have been a powerful tool and arguably inappropriate to be wielded against persons who were not authorised and subject to the conduct of business rules or supervisory arrangements as authorised persons. Equally, no case had been made out for the proposal that the regulators should be able to require directors (present and past) of listed companies, sponsors and primary information providers to commission skilled persons' reports.<sup>75</sup> The section 166 power is available in respect of authorised persons (firms, partnerships or sole traders), but not in respect of their directors nor of approved persons.

Whilst there may well be a case for the regulators husbanding their resources by outsourcing certain inquiries, and in particular to facilitate an assessment of a regulated firm's systems and controls, or the review of very significant volumes of documentation arising in connection with systemic issues within such firms, for individuals, this would very much be a sledge hammer to crack a nut – an unnecessary and disproportionate power to wield against any individual, and particularly against individuals operating outside the regulated sector.

## 6 Summary and conclusions

Financial regulation in the UK is thus receiving its third radical overhaul in just over two decades; since 1988, no regime has lasted more than 12 years. Whether we will be discussing yet another model in 2024 remains to be seen; each reform has been driven by a combination of crisis, as markets outpace regulatory structures, and political opportunism, as each significant change in political administration brings the desire to distance itself from the old.

There is no doubt that the reform proposals have come a long way since the initial proposals nearly two years ago. Many of the changes are to be welcomed, and indeed address a number of the issues we raised in our previous paper. However, there are still issues which do need to be addressed in the legislation, though time is running out. We have highlighted a number of these: the accountability and governance structure of the Bank of England, including the relationship between the FPC and the MPC; the transparency of the relationship between the Treasury, the Bank, the PRA and the FPC; distribution of responsibilities for the supervision of CMI; the lack of clarity as to the objectives and remit of the FCA, in particular the relationship between financial stability and competition; co-ordination between the FCA and PRA for dual regulated firms; the comparative lack of attention given to FCA's role as a prudential supervisor; the use of product intervention powers and their interface with EU provisions; and finally the FCA's enforcement processes and the role of the Upper Tribunal.

Whilst we examine the minutiae of the legislation relating to our own national regulatory structure, however, developments at the EU level suggest that the scope left to our new regulators to craft their own rules and even their own approaches to supervision may be significantly shaped by the new European Supervisory Authorities and the European Systemic Risk Board. Moreover, just how the new regulators will interface with the panoply of global regulatory committees is an issue which requires significant attention. The UK has arguably been more successful in pushing its agenda at the global rather than the EU level in recent years, and it is important to ensure that influence is not lost with the fragmentation of UK representation on the international regulatory committees, which could be a side-effect of these reforms. Much has been done, but there is still a great deal to do.

## Footnotes

1. *A new approach to financial regulation: the blueprint for reform*, Cm 8083, HM Treasury, June 2011 (White Paper), paragraph 1.13.
2. The FCA will be responsible for recognised exchanges. It is worth noting that the Joint Committee in its Report on the draft Financial Services Bill, Session 2010-12, HC 1447 (2011) (Joint Committee Report) recommended that prudential regulation of market infrastructure, including exchanges, should fall on the PRA, with legislation clarifying that the FCA will regulate conduct issues (paragraph 231).
3. MOU between the Treasury, the Bank of England and the Financial Services Authority, 2000, paragraph 2.
4. Section 9A Financial Services Bill 2012 (FS Bill) as inserted by clause 3.
5. Clause 57(3) FS Bill.
6. It is worth noting that in his memoirs, Alastair Darling comments that he had no power, either formal or informal, to require the Bank to provide support to Northern Rock: A. Darling, *Back from the Brink*.
7. Clause 58 FS Bill.
8. Clause 77(7) FS Bill.
9. TSC, *Accountability of the Bank of England*, Twenty-First Report of Session 2010-12, HC 874 (2011) (TSC Report).
10. Ibid.
11. TSC, *Accountability of the Bank of England – Response of the Bank of England: Response from the Court of the Bank to the Twenty-first Report from the Committee*, Twenty-seventh Report of Session 2010-12, HC 1769 (2012).
12. TSC Report, Summary.
13. Section 9C FS Bill as inserted by clause 3.
14. Joint Scrutiny Committee Report, paragraph 44.
15. Joint Committee Report, paragraph 316.
16. J. Black, 'The Credit Crisis and the Constitution' in D. Oliver, R. Rawlings and T. Prosser (eds), *The Regulatory State: Constitutional Implications* (Oxford, 2010).
17. Joint Committee Report, paragraph 49.
18. Joint Committee Report, paragraph 59.
19. White Paper, paragraph 2.135.
20. Ibid.
21. The draft MOU, with annexes, has been published: [http://www.bankofengland.co.uk/financialstability/overseeing\\_fs/fca\\_pra\\_draft\\_mou.pdf](http://www.bankofengland.co.uk/financialstability/overseeing_fs/fca_pra_draft_mou.pdf)  
[http://www.bankofengland.co.uk/financialstability/overseeing\\_fs/fca\\_pra\\_draft\\_mouannexes.pdf](http://www.bankofengland.co.uk/financialstability/overseeing_fs/fca_pra_draft_mouannexes.pdf)
22. TSC Report, paragraph 90.
23. Section s.3D FS Bill as inserted by clause 5.
24. Joint Committee Report, paragraph 291.
25. Sections 138I-J FS Bill as inserted by clause 22.
26. Section 138A FS Bill as inserted by clause 22.
27. White Paper, paragraphs 2.148-9; section 3I FS Bill as inserted by clause 5.
28. Ibid, paragraph 2.147; Section 3I FS Bill as inserted by clause 5.
29. A similar duty applies in respect of decisions by the supervising regulator not to publish directions relating to the consolidated supervision of groups.
30. Note: the TSC recommended that the FPC, not the PRA, should hold the veto power and that the legislation should detail the circumstances in which the veto may be used (paragraphs 91-97).
31. Banking Act 2009, sections 188-200.
32. FSMA (consolidated version) Part XVIII.
33. Section 2 FS Bill as inserted by clause 5.
34. Joint Committee Report, paragraph 78.
35. Section 22A FS Bill as inserted by clause 8.
36. Section 2F FS Bill as inserted by clause 5.
37. Section 3F FS Bill as inserted by clause 5.
38. Joint Committee Report, paragraph 90.
39. Part 9A FS Bill as inserted by clause 5.
40. Section 139A FS Bill as inserted by clause 22.
41. Joint Committee Report, paragraph 99.
42. TSC Report, paragraph 34.
43. Section 1B(3) FS Bill as inserted by clause 5.
44. Ibid.
45. Section 1B(4) FS Bill as inserted by clause 5.
46. White Paper, paragraph 2.111.
47. TSC Report, paragraph 28.
48. White Paper, paragraph 2.111.
49. White Paper, paragraph 2.86.
50. Joint Committee Report, paragraph 297.

51. TSC Report, paragraph 38.
52. *A new approach to financial regulation: securing stability, protecting consumers*, Cm 8268, HM Treasury, January 2012, paragraph 4.29.
53. Section 1E(2) FS Bill as inserted by clause 5.
54. White Paper, paragraph 1.42
55. White Paper, paragraph 2.92
56. TSC Report, paragraph 110.
57. Section 1C(2)(e) FS Bill as inserted by clause 5.
58. Section 137C FS Bill as inserted by clause 22.
59. White Paper, paragraph 2.99.
60. TSC Report, paragraph 166.
61. Section 137C(7)(a) FS Bill as inserted by clause 22.
62. TSC Report, paragraph 145.
63. Section 138N FS Bill as inserted by clause 22.
64. Section 137P FS Bill as inserted by clause 22.
65. White Paper, paragraph 2.105.
66. Section 387(2) FS Bill as inserted by schedule 9.
67. Section 397(1)(c) FS Bill as inserted by schedule 9.
68. TSC Report, paragraph 160.
69. Muradoglu, Yaz Gulnur, and Clark Huskey, Jennifer, *The Impact of SEC Litigation on Firm Value*. Available at SSRN: <http://ssrn.com/abstract=1094948>
70. Section 391(1)(c) FS Bill as inserted by schedule 9.
71. *Ibid*; Joint Committee Report, paragraph 258.
72. This proposal was supported in the Joint Committee Report, paragraph 348.
73. *Tribunal directs FSA to publicly censure trader for market abuse*, 2 September 2011. Available at <http://www.fsa.gov.uk/pages/Library/Communication/PR/2011/078.shtml>
74. Section 166(3)(b) FS Bill as inserted by schedule 12.
75. Directors of listed companies are in their personal capacity subject to certain limited requirements under the Disclosure and Transparency Rules, but so are persons other than directors discharging managerial responsibilities, and approved persons are subject to disciplinary powers under section 66 of FSMA. Directors of sponsors and of primary information providers may (depending on the nature of their company) not be subject to any regulatory requirements by or under FSMA.



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Julia Black joined the Law Department in 1994. She completed her first degree in Jurisprudence and her DPhil at Oxford University. Her primary research interest is regulation. In 2001-2 she received a British Academy / Leverhulme Trust Senior Research Fellowship to develop her work on regulation, and in 2007-8 was a Visiting Fellow at All Souls College, Oxford. She has written extensively in the area of regulation, and also advised policy makers, consumer bodies and regulators on issues of institutional design and regulatory policy. She is also a research associate of the ESRC Centre for the Analysis of Risk and Regulation, based at LSE.

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Martyn Hopper heads the financial services regulatory practice at Herbert Smith LLP. He is a barrister and a solicitor advocate. Prior to his return to private practice in 2004 he spent over nine years working as a senior in-house lawyer within the UK Financial Services Authority. There he was heavily involved in the development and implementation of the Financial Services and Markets Act 2000, the FSA's investigation and enforcement policies and procedures and the UK market abuse regime. After a period as Head of SFA and IMRO Enforcement he moved on to Head the then Market Integrity Group within the FSA's Enforcement Division where he led investigations and enforcement actions in relation to market conduct, corporate disclosure and investment banking conduct of business matters.

Since moving to Herbert Smith, Martyn has advised a wide range of clients including investment, commercial and retail banks, insurers, asset managers and brokers on regulatory issues. His work has involved advice on compliance risk management issues, conducting internal reviews and investigations and representing clients in regulatory investigations, enforcement actions and related tribunal and court proceedings.

Breaking up is hard to do:  
the next stage

**Notes**

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