I. Introduction

1. The Building Societies Association represents mutual lenders and deposit takers in the UK including all 48 UK building societies. Mutual lenders and deposit takers have total assets of over £365 billion and, together with their subsidiaries, hold residential mortgages of almost £235 billion, 19% of the total outstanding in the UK. They hold more than £245 billion of retail deposits, accounting for 22% of all such deposits in the UK. Mutual deposit takers account for about 36% of cash ISA balances. They employ approximately 50,000 full and part-time staff and operate through approximately 2,000 branches.

II. Key Points

Effectiveness and cost of future regulatory arrangements

3. On a broad point, it is of the utmost importance that the regulators - the Financial Conduct Authority (FCA) in particular - ‘hit the ground running’. The FSA’s supervisory enhancement programme, its strengthened consumer redress powers, and the wide range of recent and current initiatives relating to conduct of business (most of which will be completed by the end of 2012 - see the table at the end of this executive summary) should put the FCA, by the time of its planned inception, in a position where it can move forward with strong, well-thought-out regulatory approaches and tools that have real shelf life. A hiatus while the new bodies “get up to speed” is in no-one’s interest.

4. Notwithstanding the natural desire of any new organisation to differentiate itself from its predecessor and assert a distinctive identity, after the upheavals of recent years it is imperative that the FCA does not seek to re-invent the wheel soon after its inception. We need strong, focused, impartial and proportionate conduct of business regulation to become ‘business as usual’ under the new framework right away – it is crucial to consumers, businesses and the UK economy that a strong degree of certainty returns.

5. In addition to the above point, our key outstanding concerns are about the effectiveness of practical arrangements and their cost. We welcome the commitments, set out in the CP, to deliver a new regulatory regime that is efficient (with due regard paid to value-for-money and cost-effectiveness) and proportionate, and that incorporates effective co-ordination between the regulatory bodies. However, the CP also states that “detailed day-to-day arrangements” will be left to the individual regulators to decide (paragraph 5.28). This leave two key questions unanswered –

- What does an efficient, proportionate regulatory regime look like?
- What controls are required to ensure that such a regime is delivered in practice?

6. While the CP recognises the need for cost control, the relevant control mechanisms (‘efficiency’ and ‘proportionality’ principles) are not, in themselves, adequate to ensure effective regulatory arrangements and prevent the overall regulatory costs increasingly significantly again – we believe that greater focus on these aspects of the exercise is required as matters progress and we provide detailed information in this response.

7. In summary, we believe that, in order to deliver an efficient and proportionate regulatory regime, the authorities should commit to a close examination of the following ten matters and, where practicable, they should be included in the legislation –

(i) a common gateway for firms' authorisations, approvals, variations, waivers, notifications, reporting etc: dual-regulated firms - ie all BSA members, banks, insurance companies etc - should not have to duplicate communications with the Prudential Regulatory Authority (PRA) and the FCA.
(ii) the ‘integrated regulatory reporting’ system (GABRIEL) be maintained within the common gateway

(iii) retention of a single regulatory Handbook, with one of the two regulators being the contact point in areas of potentially shared responsibility

(iv) sharing by the PRA and FCA of back-office functions, should be the norm (given that the FSA currently has a single back-office, as shown on its 4 April 2011 organogram, notwithstanding the functional separation of the prudential and conduct business units), and exceptions should be individually justified

(v) co-ordination between the PRA and FCA in respect of regulatory supervision/visits to minimise duplication for firms, eg on informational requirements preceding regulatory visits, or concurrent but unrelated visits by PRA/FCA

(vi) co-ordination between the PRA and FCA in respect of regulatory approaches (eg to rule-making, enforcement etc)

(vii) no overlaps between the PRA and FCA eg on the subject matter of discussions and consultations, thematic work, enforcement etc and there should be a senior Treasury official charged with ensuring that, while the regulators must of course actively co-ordinate, they do not allow any drift into a position where their functions overlap

(viii) careful planning be undertaken to ensure that the regulatory burdens under the new arrangements new arrangements do not disproportionately affect smaller firms

(ix) methods of ensuring that the proposed IT spend is the most cost-effective way forward, and

(x) apart from transitional costs, an overall cap on the first year budgets of the PRA and the FCA should be introduced, which should be no higher than the current FSA budget (and clear controls be put in place on levels of future budgets).

Welcome elements

8. The BSA finds much to welcome in the CP, including the following important matters of principle -

- **New strategic and operational objectives** for the Financial Policy Committee (FPC), PRA and the FCA. We strongly support the operational principles to be introduced for the PRA and the FCA, including regulatory efficiency and proportionality (value-for-money and cost effectiveness), openness and transparency, regulatory accountability, senior management responsibility in firms, and consumer responsibility. The success of these objectives going forward is very important to the financial services sector’s contribution to a strong UK economy.

- The new arrangements will recognise corporate diversity – we welcome the Government’s decision that both the PRA and FCA will be required
specifically to take account of mutuals in relation to cost-benefit analyses - but this is not the fundamental point: the main issue is that there should be a level playing field for businesses of different corporate forms (see response to question 23 below).

We had hoped for a more fundamental, specific commitment to diversity of corporate structure, as flagged in the earlier CP. Nonetheless, such an approach appears to be integral to the requirement for proportionality; the CP states (paragraph 4.25) “Proportionality also means that the regulator must tailor its actions to the specific characteristics of the sector being regulated.” However, we would welcome confirmation that our interpretation is correct.

- A commitment to strong co-ordination between the regulatory bodies (with ultimate primacy for the PRA over the FCA in certain circumstances). Co-ordination between the regulatory bodies is a key to their success.

- The measures to help ensure proper coordination with the EU and internationally. It is crucial for the UK economy that our regulators are fully involved at EU level, in particular. In this context, we call for an end to the damaging practice of legislative ‘front-running’, whereby UK laws are introduced in the knowledge that EU legislation (on the same, or substantially the same) matters is already in train.

- Wherever appropriate, the FCA will have to exercise its general functions in a manner intended to promote competition.

Remaining matters of concern

9. However, some aspects of the CP continue to give rise to concern, especially the following -

- While the debate over the regulatory architecture is now largely settled, we do have some outstanding concerns about the accountability of the Bank of England and believe that it is time to strengthen the resources of the Treasury Select Committee.

- Both the FPC, in its macro-prudential role, and the PRA, in its micro-prudential role could cut across wider Government policies and we believe that the new arrangements need to have relevant safeguards.

- The characterisation of the FCA as “consumer champion” remains and the explanation in the CP - while helpful - does not, in our opinion, provide satisfactory reassurance. In view of the fact that the Government is continuing with the description, we believe that a statutory requirement on the FCA to act in a fair and impartial manner is now necessary.

- There will be a more intrusive, interventionist approach to conduct of business regulation by the FCA - while not necessarily objecting to this, the extent of the proposed product intervention powers seem to pre-empt the continuing FSA discussion (DP 11/1), which the BSA will respond to in the next week. Furthermore, the CP appears to revive discussion of limits on loan-to-value or loan-to-income limits, in relation to conduct of
mortgage business, which the FSA had ruled out from a conduct of business perspective as part of the mortgage market review.

- There are worrying signs that **firms' rights** to challenge regulatory decisions and regulatory certainty will be diminished by aspects of the proposals – notably, the proposed withdrawal of a 'full merits review' basis of appeal to the Upper Tribunal in respect of PRA enforcement processes (paragraph 3.32), and the plans for the publication of FCA warning notices (paragraph 4.88). We question whether these changes are compatible with the rights guaranteed under Article 6 of the European Convention on Human Rights: if, as we argue, they are not, they must not proceed. We would also like to see a legislative provision making it explicit that, in order to have **regulatory effect**, measures introduced, or statements made by, the FCA must go through the relevant statutory processes.

- The **planned timetable** is to put the regulatory architecture in place by the end of 2012. The BSA view is that, while this high-level timetable may be practicable, it is likely that crucial detailed arrangements (such as systems and other technical matters) will take longer. It is important not to underestimate the logistics of these underlying technical exercises. The need for caution has been highlighted by the recent experience of FSA online notice and applications (ONA) with, first, the deferment of the implementation of the new CF31 approved persons function and, more recently, with the delay in the implementation of the new significant influence functions.
### Recent and current exercises potentially affecting conduct of business
(approx. last 3 years)

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<tr>
<th>Beginning</th>
<th>Exercise (responsible authorities in brackets)</th>
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<tr>
<td><strong>General</strong></td>
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<td>2008</td>
<td>• Consumer Protection from Unfair Trading Regulations 2008 (OFT)</td>
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<td>2008</td>
<td>• Tougher enforcement (FSA) – total fines 2007: £5 million; 2010: £89 million</td>
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<td>2009</td>
<td>• Treating customers fairly (FSA) – from the ‘embedding’ deadline: end 2008 – flagship project for principles-based regulation</td>
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<td>2009</td>
<td>• Publication of complaints statistics (FOS and FSA)</td>
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<td>2010</td>
<td>• ‘Outcome-based’ (‘intrusive’) conduct regulation strategy (FSA)</td>
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<td>2010</td>
<td>• Consumer redress powers (FSA)</td>
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<td>ongoing</td>
<td>• Simple financial products (HM Treasury)</td>
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<td>ongoing</td>
<td>• Product intervention (FSA)</td>
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<tr>
<td>ongoing</td>
<td>• Consumer Rights Directive (European Commission)</td>
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| Individual Sectoral | |
| 2009 | • Banking regulation (FSA) |
| 2009 | • Payment Services Regulations (FSA) |
| 2009 | • Lending Code - subscribers only (Lending Code Standards Board) |
| 2010 | • Irresponsible lending guidance (OFT) |
| 2011 | • Consumer Credit Directive - implemented in UK by various regulations (OFT) |
| ongoing | • Consumer credit and personal insolvency review (BIS) |
| ongoing | • Future regulation of consumer credit consultation (HM Treasury and BIS) |
| ongoing | • Mortgage market review (FSA) |
| ongoing | • Consumer protection in the mortgage market (HM Treasury) |
| ongoing | • Responsible lending and borrowing (European Commission – potential directive) |
| ongoing | • Personal current accounts market study (OFT) |
| ongoing | • Retail distribution review (FSA) |
| ongoing | • Structured deposits proposals (European Commission) |
| ongoing | • Markets in Financial Instruments Directive review (European Commission) |
| ongoing | • Insurance Mediation Directive review (European Commission) |

The Building Societies Association
April 2011
III. Other Commentary and Responses to Consultation Questions

Bank of England and Financial Policy Committee

10. The BSA observes that the debate about the regulatory architecture is now largely settled. The division of responsibilities between the FPC and PRA on, respectively, macro and micro-prudential lines should enable the bodies to focus on their own key responsibility, under the overall management of a single institutional structure. In principle, this should help avert a repetition of some of the fundamental problems experienced with the Tripartite under the earlier regime.

11. However, the need for co-ordination remains, so it will be essential for the Bank to identify interdependencies between the different elements in the arrangements and manage them effectively. The importance of effective management by the Bank and proper co-ordination between the new regulatory authorities is identified in chapters 1 and 2 of the CP.

12. In addition, the BSA supports and endorses –

- the FPC’s strategic objective concerning the stability of the UK financial system
- the principles, set out in paragraph 1.25, to which the PRA will also be required to have regard
- the FPC’s operational objectives (set out in paragraph 1.26)
- the requirement, where compatible with its objectives, for the FPC to discharge its functions in a way that promotes competition.

We believe that the formula for ensuring that the FPC takes into account the potential for adverse impacts on economic growth (set out in paragraph 1.21) needs strengthening and it would be preferable to express it as a positive duty.

13. There is an argument that the concentration of so many powers within the Bank of England might fragment the Bank’s focus. We provide some suggestions regarding Bank of England accountability later in this response.

14. We agree with the Treasury Committee that, if the FPC is to be given lead responsibility for securing financial stability, there needs to be clarity about what such “stability” means. Whilst this is by no means an easy matter, more detailed examination is necessary, including how success will be measured and what tools will be used to achieve it.

15. We support the approach that would permit the FPC to direct the PRA and FCA in certain circumstances, but leaving them with discretion - in the case of recommendations, rather than directions - not to comply, provided they explain their reasons. This framework, as explained in paragraphs 2.36 - 2.45, should give appropriate flexibility to the overall arrangements, if used appropriately.
1 What are your views on the likely effectiveness and impact of these instruments as macro-prudential tools?

16. First, we agree strongly with the TSC’s recommendation that the secondary legislation that will establish the FPC’s detailed toolkit will be subject to affirmative procedure, and we welcome the Government’s acceptance of this (paragraph 2.44). Some macro-prudential tools are, of course, already prescribed by international standards, notably the binding European legislation corresponding to Basel III (with implementation beginning about the same time as the new UK financial regulators are established). The European dimension must never be overlooked.

17. We also welcome the discussion in paragraphs 2.89 to 2.97 about the transparency and accountability of the FPC’s use or proposed use of such tools. We strongly support the general statement in paragraphs 2.49 and 2.50 -

“It will be vital that the FPC set out clearly how it intends to use the tools and the rationale for their use and provide an ongoing assessment of how it believes they are working…..the Treasury may require the FPC to publish a policy statement in advance, setting out how it plans to employ the tool and the circumstances in which it might be used.”

We accept, of course, that it would not be appropriate or desirable for the FPC to consult prior to each use of one of its macro-prudential tools. But we strongly endorse the general point that FPC should be obliged to consult on how it would envisage using its toolkit. This would help to develop understanding of how macro-prudential tools affect the wider economy, and therefore also have an impact on the achievement of the MPC’s objectives.

18. The assessment called for in paragraph 2.49 should also extend to any spillover effects and unintended consequences of its macro-prudential tools, many of which are relatively untested at present. For example, in relation to collateral requirements (paragraphs 2.63 – 2.64), the CP envisages the possibility of the FPC seeking, as is the power in certain other jurisdictions, to introduce controls on loan-to-value ratios across the whole mortgage market. This would be a problem if the FPC made such a decision with insufficient understanding of the impact it might have on broader policy objectives; for example, to see particular trends develop in respect of the number of owner-occupiers, or tenanted properties, or in, say, land use and the growth, or otherwise, in the provision of social housing. Therefore, caution would need to exercised to ensure that FPC activity did not impinge on a wide range of non-financial objectives as well.

19. Furthermore, there should be thorough forward and back testing, using appropriate models, of the regulatory tools - not just for the FPC’s macro-prudential toolkit, but also for the tools potentially to be used by PRA. This should identify (within the limitations of any models) which tools, if used in known circumstances in the present or recent past, would have produced which outcomes. Such a process could be invaluable in equipping the regulators for the wise use of their regulatory tools in future. In view of the stringent stress testing requirements now placed on firms (eg in respect of capital and liquidity), it would seem very odd if regulatory tools were not similarly subject to stringent testing.
2 Are there any other potential macro-prudential tools which you believe the interim FPC and the Government should consider?

20. In our response to the previous CP *Judgment, Focus and Stability*, we stated the following –

“To the list of macro-prudential tools must be added the separate point of the proposed funding mechanism for deposit protection envisaged in the **European Commission’s proposals for an amended deposit guarantee schemes directive (DGSD).** Building up a deposit protection pre-fund at the speed and scale envisaged by the Commission would have a major impact on profitability in building societies (and banks) over the next decade. This would compromise the UK authorities’ ability to deploy other macro-prudential tools.”

We stand by this position and believe that it is a message that the UK authorities need to carry forward strongly in the EU. And, to the extent that any modified proposal for pre-funding may finally come into force, it is essential that its potentially severe macro-prudential impact is properly taken into account in considering whether any other tool is needed. Once implemented, the pre-funding tool cannot temporarily be laid aside in favour of another tool – it will be a constant baseline factor for 10 -15 years.

3 Do you have any general comments on the proposed role, governance and accountability mechanisms of the FPC?

21. Taking a broad view of the proposed arrangements, there is still a risk of the emergence of an excessively powerful Bank of England unless robust accountability and transparency provisions are put in place. The new arrangements, as proposed, will mean that the Governor of the Bank of England will be Chairman of the MPC, the FPC and the PRA, as well as having oversight of the FCA, and the bank resolution regime.

22. Therefore, we welcome the Government’s recognition of the need for strong accountability, with mechanisms and controls to be put in place, as set out in the CP, such as publication of FPC meeting records, a twice-yearly financial stability report, certain accountability mechanisms for the FPC’s use of directions and toolkits, audit of the FPC and PRA by the National Audit Office, a Treasury power to order independent inquiries into regulatory power, further governance and accountability arrangements for the PRA among others.

23. We believe that the proposed arrangements could go further, without diminishing - but, indeed, reinforcing - the overriding importance of financial stability. In UK financial services, and banking in particular, systemic risk is concentrated in relatively few institutions – a fact acknowledged by the Independent Commission on Banking. The combination of this concentration of systemic risk and the concentration of power in the Bank of England means that it would take only a very few people to make wrong decisions at critical times for a future financial crisis to be dealt with in a sub-optimal manner. Checks and balances on the Bank are required to mitigate this risk and certain specific suggestions are set out below.

24. Key among the accountability mechanisms to which the enhanced Bank will be subject is accountability to Parliament, principally via the Treasury Committee.
Given the importance of ensuring appropriate levels of political accountability, it would seem now to be the right time to assess whether the Treasury Select Committee is properly resourced.

25. The BSA understands that the Committee has very few support staff, certainly compared to the Bank of England and other regulatory agencies; given the high profile of its work, the range of reports which it publishes, and the possible enhancement of its responsibilities discussed in this note it may be unrealistic for it to continue with current low staffing levels. There would appear to be scope for the formal functions of the Treasury Select Committee to be enhanced; for example by routinely interviewing new appointments to the board of the new regulators.

26. Moreover, arguably, the concentration of power in the Bank of England, and the very wide range of subjects already covered by the Treasury Committee will be such as to warrant a dedicated Select Committee to provide adequate oversight of its activities. Typically, Select Committees cover the areas that are the particularly the responsibility of a Department of State; however, we would support moving away from this model, with the creation of either a Financial Regulation Select Committee, or a Bank of England Select Committee.

27. The financial crisis of the last few years has had, and is having, a huge effect on the structure of the banking industry in the UK, and on the structure of regulation. On the face of it, it would be odd if the arrangements for Parliamentary oversight of regulation of the finance industry were not even discussed.

28. We recognise that the position of the FPC, as a body with high-level responsibility for financial stability, is substantially different from that of the PRA, whose primary responsibility is the prudential regulation of individual businesses. Nevertheless, it would be appropriate to examine whether the FPC, like the FSA currently, should be required to have regard to good corporate governance in managing its affairs. Arguably, it should also be required to have regard to the views of the statutory panels.

29. Macro-prudential decisions are essentially about seeking an optimum combination of financial stability with growth in the wider economy, as is implicitly recognised in the FPC’s objectives. Too much stability may be accompanied by economic stagnation, and too much credit growth may endanger stability. But this shows that financial stability is not a good that can be pursued in isolation, but is inevitably connected with wider economic matters, and indeed with several aspects of social policy which are the preserve of the elected Government – such as access to housing and access to credit. Therefore, it may not be possible for the FPC to be as explicitly independent of Government influence as the MPC.

30. There is also the specific interaction between monetary policy and macro-prudential regulation. Co-ordination is the key, incorporating such matters as cross-membership (of the MPC and FPC, with the Governor as chairman of both) and sensible sequencing of meetings. We agree with the Treasury Committee that, so that policies on financial stability can be coordinated more effectively, provision for joint MPC/FPC meetings may be required.

31. The independent members of the FPC will play a very important role but, whilst the MPC has four external members out of a total of nine, the FPC would have five external members out of twelve. We agree with the Treasury Committee that a better balance between internal and external members of the FPC could be achieved by increasing the number of external members on the FPC, to say six. Further, to aid
the achievement of the FPC’s statutory objective of not having a significant adverse effect on the capacity of the financial sector to contribute to the growth of the UK economy, it would be beneficial to appoint more external members with direct and recent experience of working in the financial sector. In the interim FPC, just one out of the four external members has such direct experience.

4 Do you have any comments on the proposals for the regulation of systemically important infrastructure?

32. We have no comments on the proposals, which seem sensible. But we have two comments on the measures proposed in respect of crisis management (dealt with in paragraphs 2.137-157 of the CP). First, the proposed Memorandum of Understanding between the Treasury and the Bank group seems a sensible idea. However, it appears likely at least to overlap substantially with the statutory Code of Practice on the use of the SRR required under the Banking Act 2009. This overlap should be dealt with and the Memorandum, like the Code, should be subject to full public consultation.

33. Second, the Memorandum will rightly focus inter alia on questions about the risk to, and possible use of, public funds. We have previously observed – in the context of the SRR and its Code of Practice – that it is not only public funds (taxpayers’ money) that need to be protected. Funds held in the FSCS, or capable of being levied by the FSCS on banks and building societies, are not a “free good”. They can be used either to finance a bank resolution or to pay deposit compensation directly. Where used for bank resolution, choices made as to which SRR tools are used, and at what stage early interventions are or are not made, could affect the ultimate cost via the FSCS to banks and building societies.

34. Just as the Chancellor rightly protects the taxpayer interest, we argue that one of the authorities – perhaps the Bank – should also be tasked with minimising the recourse to the FSCS (whether as a resolution fund or as a compensation fund). Money drawn from the FSCS ultimately constitutes a “tax” on building societies, banks and their customers. And on the principle of no taxation without representation, it is also time to upgrade the formal role that deposit-takers have in overseeing the conduct of any SRR interventions that use FSCS money. The FSCS should be made accountable to a creditors’ committee in respect of any interventions along the lines of Bradford & Bingley and the Icelandic banks.

35. Finally, on the EU crisis management proposals, we welcome the Government’s support (paragraph 2.156) for prevention and early intervention, and flexibility for national authorities to use tools and powers within the parameters of their own national arrangements. The BSA made similar points in its own submission to the Commission.

Prudential Regulation Authority

36. As noted above, we welcome the principles, set out in paragraph 1.25, to which the PRA will also be required to have regard. We believe that there should be stronger accountability and controls in respect of the PRA budget.

37. There needs to be some mechanism whereby the PRA’s micro-prudential policy initiatives should also have regard to the Government’s wider economic and social policy imperatives. We are very concerned about the posited withdrawal of the right of firms to appeal on a ‘full merits review’ basis to the Upper Tribunal in respect
of PRA enforcement. Also, it will be important for the PRA to develop relevant approaches to the consultative process.

5  **What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the PRA?**

38. Subject to comments elsewhere in this response (eg regarding corporate diversity – see below), we support the objectives and principles.

6  **What are your views on the scope proposed for the PRA, including Lloyd’s, and the allocation mechanism and procedural safeguards for firms conducting the ‘dealing in investments as principal’ regulated activity?**

39. The BSA has little experience of this particular topic and, therefore, we make no comments.

7  **What are your views on the mechanisms proposed to make the regulator judgement-led, particularly regarding: rule-making; authorisation; approved persons; and enforcement (including hearing appeals against some decisions on a more limited grounds for appeal)?**

40. Understandably, there is little current detail on the judgement-led approach and the proactive intervention framework but, by and large, what is set out appears to be sensible and we await the further information referred to in paragraph 3.33.

41. The BSA has one comment, regarding enforcement. We believe that the current rights of firms to appeal, on a ‘full merits review’ basis, to the Upper Tribunal in respect of supervisory decisions should not be reduced.

42. Businesses have human rights (*Wilson v First County Trust* [2001] 3 All ER 229). Article 6(1) of the European Convention on Human Rights (ECHR) begins by stating that –

   "In the determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent tribunal."

The ECHR was incorporated into UK law by the Human Rights Act 1998. Because of its limited scope, judicial review falls considerably short of providing an appeal. It is inappropriate to interpret human rights restrictively (*Delacourt v Belgium* (1970) 1 EH).

43. In view of all these matters, we believe that the Government needs to reconsider its proposals regarding enforcement – which, as they stand, could be in breach of Article 6.

8  **What are your views on the proposed governance framework for the PRA and its relationship with the Bank of England?**

44. The governance framework proposed for the PRA appears to be clear and broadly appropriate. However, we have no direct experience of the Court of the Bank of England and are unqualified to comment on the Court’s suitability to the various roles set out in the CP.
45. One point does concern us and that is the matter of accountability in respect of the PRA budget. Under current plans, the Court will have the responsibility of approving the PRA’s objectives for funding, financial management, budgets and remuneration policies. We would like to see greater controls (for example, a more detailed remit for the National Audit Office).

46. We would also like to see greater co-ordination in respect of the budgets of the PRA and the FCA. Indeed, we believe that there should be some method for controlling the combined budget of the two organisations because –

- In the light of the events since 2007, the FSA carried out a ‘Supervisory Enhancement Programme’, which involved a structural re-organisation and led to a very significant increase in FSA staff numbers - the FSA budget for mainstream regulatory activity in 2000/01 was £162.5 million; ten years later, the broadly corresponding figure had increased, by over 300%, to £490.9 million (RPI increased by just over 31% in the same period)
- The PRA’s responsibilities derive directly from those currently held by the FSA
- At a time of national financial constraint, regulatory bodies – like all other organisations - should exercise financial restraint.

We provide more detail below, in respect of the FCA.

9 What are your views on the accountability mechanisms proposed for the PRA?

47. The BSA broadly supports the PRA’s independence in operational matters, subject to the points made elsewhere in this response. We believe that the PRA should be subject, essentially, to the same statutory accountability provisions as the FSA. The BSA also believes that the PRA should have regard to the primary objectives of the FPC and FCA. Financial stability is overriding, but it is imperative that the three organisations liaise closely and that one does not cut across what the others are doing. As we stated in our response to last year’s CP, Judgment, Focus and Stability, it is difficult to reach any conclusion other than one whereby the PRA at least has regard to the primary objectives of the FPC and FCA. We recognise that the coordination requirements go some way towards meeting this point.

48. We welcome the fact that the new arrangements recognise corporate diversity – we note the Government’s decision that both the PRA and the FCA will be required specifically to take account of mutuals in relation to cost-benefit analyses. However, as we explained in our response to the previous CP, there are strong reasons for both the PRA and the FCA to be required to have specific regard to corporate diversity and we are disappointed at the decision not to implement such requirements. Nonetheless, such an approach appears to be integral to the requirement for proportionality; the CP states (paragraph 4.25) “Proportionality also means that the regulator must tailor its actions to the specific characteristics of the sector being regulated.” However, we would welcome confirmation that our interpretation is correct.

49. While it would not be appropriate for the PRA’s day-to-day supervision of firms to come under Government control (and thereby responsibility), nevertheless there needs to be some mechanism whereby the PRA’s micro-prudential policy initiatives
should also have regard to the Government's wider economic and social policy imperatives. Otherwise, there is the risk of measures that may appear justified in a narrow regulatory context but which are clearly sub-optimal, or even undesirable, when viewed against the wider context. Micro-prudential regulation is not an end in itself - it should serve wider societal objectives. We have made similar comments (above) about the FPC’s macro-prudential role.

50. The FSA has a culture of consultation because of the requirements, prescribed by the FSMA, to consult on prospective rules and guidance. The Bank of England has not been subject to such requirements and it will be important for the PRA to develop relevant approaches to the consultative process.

10 What are your views on the Government’s proposed mechanisms for the PRA’s engagement with industry and the wider public?

51. The arrangements appear to be appropriate and we particularly support the PRA’s duty to consult practitioners (paragraph 3.70). We appreciate that the detailed arrangements will need to be worked out.

Financial Conduct Authority

52. Our key concerns are that the FCA should ‘hit the ground running’ as a conduct of business regulator, and that it should coordinate effectively with the PRA. We make a number of specific, practical suggestions about regulatory coordination.

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

• General

53. It is of crucial importance that the regulators are able to ‘hit the ground running’. This is particularly important in respect of the FCA as a conduct of business regulator. It would be most unfortunate if, on, or soon after, its inception the FCA decided to revisit conduct of business strategy. The FSA has already done a great deal of good work in this area and we believe that the next eighteen months or so should be used to refine the regulatory approach to conduct of business so that, from the FCA's inception, there is much greater certainty than hitherto. This is a matter of considerable importance to consumers, businesses and the UK economy.

54. There is considerable evidence that, over the last two years or so, the supervisory enhancement programme has made the FSA a stronger and more effective conduct of business regulator than it was in the past. This, together with its recently enhanced consumer redress powers and the wide range of current initiatives relating to conduct of business (see the table above) should put the FCA, by the time of its planned inception at the end of 2012, in a position where it can move forward with strong, well-thought-out regulatory approaches and tools that have real shelf life. In particular, the rules should be designed in such a way as to be, if not fully ‘future-proofed’, at least capable of addressing changed circumstances and new challenges without the perceived need to revisit the entire regulatory strategy or major aspects of it because, for example, of a new mis-selling episode.

55. Long-term, it would make great sense to simplify laws and regulations relating to conduct of business. The BSA has had a policy on this matter for some years www.bsa.org.uk/policy/response/dberr.htm and, while we welcome some recent changes, we believe there is much still to be done. We firmly believe that
simplification would favour the UK economy, consumers, and well-run firms that have a genuine culture of treating customer fairly. But we recognise that any major work in this area would need to be conducted in the long-term – the priority now is to establish the new regulatory arrangements and to move forward with strong, clear conduct of business regulation.

56. We note and welcome the clarification of the FCA’s “consumer champion” role and, in particular, the confirmation (in paragraph 4.9) that the FCA will be an entirely impartial regulator from whom firms and consumers can expect fair treatment. The BSA set out detailed reasons for our concern about this characterisation in our response to the previous CP, Judgment, Focus and Stability. In the light of the assurances in the CP, we presume there would be no objection to including a requirement in the forthcoming Bill on the FCA to be a fair and impartial regulator.

- The FCA’s proposed objectives and PRA/FCA principles

57. Regarding the FCA’s objectives, we stated in our response to the previous CP, Judgment, Focus and Stability -

“Within the new framework, however, the BSA broadly agrees with the proposed formulation of the [FCA’s] primary objective; namely, that of ensuring confidence in financial services and markets, with particular focus on protecting consumers and ensuring market integrity.”

We commented in much more detail in our earlier response. In the light of the fact that the proposed objectives remain broadly the same, we make no further comment.

58. Turning to the proposed regulatory principles, in our earlier response we strongly supported the provision of a consistent set of regulatory principles for both the PRA and the FCA. Therefore, we welcome the decision (referred to in paragraph 4.23) that the two organisations will share the common principles of –

- efficiency,
- proportionality
- consumer responsibility
- responsibilities for senior management
- openness and disclosure, and
- transparency.

59. Some of these principles are already well-known and established; others will need fleshing out in due course. The first principle, which requires the regulators to use their resources in the most efficient and economic way, could be re-inforced by a number of practical measures. For example, by the introduction of -

- methods of ensuring that the proposed IT spend is the most cost-effective way forward, and
• apart from transitional costs, an overall cap on the first year budgets of the PRA and the FCA, which should be no higher than the current FSA budget (and clear controls be put in place on levels of future budgets).

60. Furthermore, we believe that impact assessments should not, in future, be limited only to the costs and benefits of the particular measure, or set of measures, being considered, but should encompass separate, related measures and recent changes that have taken place in the same, or substantially the same, area. With so many regulatory and legal changes, affecting conduct of business, in recent years (and so many more in the pipeline) cumulative costs and benefits should be taken into account.

61. A good example of the importance of this suggestion, in respect of cumulative costs, are those incurred by consumer credit businesses following changes to law and regulation in that area, resulting from the following –

• the major revision of the legislation that resulted in the Consumer Credit Act 2006 and a series of regulations designed to implement it over the following couple of years

• the equally substantial changes resulting from the Consumer Credit Directive 2008 (implementation was completed earlier in 2011)

• potentially, the unraveling of all consumer credit legislation, and inclusion of it in a regulatory handbook, as envisaged by the recent consultation, Reforming the Consumer Credit Regime.

It is questionable whether the benefits to consumers brought about (or potentially to be brought about) by the above changes justify the cost of the constant upheaval over a long period, which is ultimately borne by consumers themselves.

62. The cost of cumulative changes is only one part of the picture – to that must be added the cost of overlapping changes (see, for example, the range of initiatives set out in table earlier in this response, many of which cover much the same ground). In conclusion, we believe that impact assessments, taken in isolation, are nowadays – too limited, in their present form, to be of much value.

63. Proportionality is potentially a key principle because of the very wide range of firms that the regulators will be responsible for and the need to tailor regulatory approaches accordingly. We hope, and would welcome confirmation that, the principle of proportionality will embrace different business forms (eg mutuals, as well as plcs) in addition to firms of differing size and complexity of operation.

64. Subject to our reservations about the “consumer champion” label for the FCA (see above), we fully support the inclusion within the FCA’s remit a key objective of capturing better outcomes for, and protection of, consumers. We also welcome the recognition of consumer responsibility – we believe that, while the matter is not always straightforward, it is clearer than is sometimes recognised, and the BSA has a long-standing policy on the matter; see for example our response to the FSA discussion paper DP 08/5 - www.bsa.org.uk/policy/response/consumer_responsibility.htm.

65. We agree that, although major financial crime could potentially have a destabilising effect on a firm, it is closer to the kind of conduct issues to be dealt with,
for dual-regulated firms, by the FCA than to the prudential matters that the PRA will be responsible for. Therefore, the BSA supports the decision to give the FCA a free-standing duty regarding financial crime prevention.

66. Regulatory transparency is very important to effective conduct of business regulation and to trust in the regulatory authority. We strongly support its inclusion among the proposed regulatory principles.

12 What are your views on the Government’s proposed arrangements for governance and accountability of the FCA?

67. The BSA supports the proposals regarding governance and accountability of the FCA, including retention of the practitioner and consumer panels, maintenance of the arrangements for the investigation of complaints, freedom of information provisions and reporting to HM Treasury. We have a small number of qualifications, one high-level and the others technical (but, nonetheless, important in principle), as follows.

- **FCA as “consumer champion”**

68. As noted above, we believe that the FCA’s characterisation as a “consumer champion” needs to be counterbalanced by a statutory requirement that it conducts itself in a fair and impartial manner, and we explained our position in detail in our response to the earlier consultation *Judgment, Focus and Stability*.

- **Regulation by speech**

69. While comment by regulatory officials often provides welcome illumination to the regulator’s precise objectives in pursuing a particular course of action, and in answering firms’ questions about regulatory activity, the problem of ‘regulation by speech’ needs to be addressed. By way of explanation, we repeat the relevant passage from our response to the earlier consultation *Judgment, Focus and Stability* -

“There is a further change that needs to be made to help ensure a properly accountable [FCA]. Currently, speeches by senior FSA staff, although explicitly not binding, may nevertheless be taken into account in enforcement actions. While regulated firms should of course read relevant speeches by the regulator as far as practicable (but bearing in mind that many firms are small and the speeches are numerous – about 60 in the year from October 2009 to September 2010), speeches are not an appropriate medium for delivery of binding regulatory material or even formal guidance.

The BSA believes that the relevant provisions should be clarified to make it explicit that speeches have no formal regulatory status, are not binding on firms and are not material to the enforcement process. As, for example, the FSA’s Annual Enforcement Performance Account 2009/10 and the increasing size of fines levied by the FSA demonstrate, the FSA has (and the [FCA] will have) plenty of powerful formal regulatory tools. We believe that ‘regulation by speech’ to the extent that it occurs is inappropriate because not only is it unnecessary, but it also potentially circumvents the normal - and proper - controls on regulatory activity.”
As the current CP is silent on this matter and we re-iterate our concerns now and call on the Government to respond appropriately in the forthcoming legislation.

- **Guidance consultations**

70. In October 2010, the FSA introduced a new “guidance consultation” (GC) process. The website says its use might include some Dear CEO letters and good and bad practice guides (speeches, CEO letters and good practice guides etc are not subject to safeguards on rules or guidance on rules as laid down by sections 155-157 of the Financial Services and Markets Act 2000). Staff in regulated firms have been finding, however, that the content of some of these GCs are more akin to what is normally found in rules or guidance on rules.

71. Since their introduction, there have been several such guidance consultations. According to the notice that announces the new GC process, the FSA will “normally consult on that guidance for a minimum of two weeks”(www.fsa.gov.uk/pages/Library/Policy/guidance_consultations/new_process/index.shtml). This minimum appears to have become the norm - of the 16 GCs issued to the end of March 2011, 12 had a two-week deadlines and only four had longer deadlines. This does not leave firms, or indeed trade body staff, sufficient time to consider the guidance under consultation.

72. The timing of the consultation is, sometimes, equally impractical. For example, the consultation on the implementation of systems and controls was issued late on 7 December 2010 with a deadline of 23 December.

73. The notice on GCs says that the FSA is “introducing a new process for issuing general guidance that relates to FSA rules but is initially published outside of our Handbook”. There is a concern that initially should not mean that such guidance will merely move at some future date into the Handbook and not be part of the consultation process as laid down by the FSMA.

74. There is a worrying blurring of procedures here - the FSMA (section 157(3)) is quite clear that (subject to very limited exceptions) all FSA guidance on rules, like the rules themselves, must be made in accordance with the procedures in sections of FSMA section 155(1),(2),(4-10)) – regardless of whether or not it is in the Handbook. A related area of concern is the lack of a cost-benefit analysis in GCs. To date, the vast majority did not include an impact assessment. When any change to a process is proposed rarely is there no cost involved but, as we note earlier in this response, we need broader impact assessments.

75. In conclusion, we believe that the legislation should be explicit that –

- the FCA is obliged to conduct its activities in a fair and impartial manner, and
- only rules and guidance that have been through the relevant process laid down by FSMA (or its successor) will have regulatory effect or will be relevant to enforcement proceedings.
13 What are your views on the proposed new FCA product intervention power?

76. The BSA will respond in full to the FSA’s discussion paper, DP 11/1 Product Intervention, the deadline for which is soon after the response date for this CP. We can note, at this stage, that the extent of the proposed product intervention powers (see paragraphs 4.60-4.68 of the CP) seem to pre-empt the continuing FSA discussion.

14 The Government would welcome specific comments on:
• the proposed approach to the FCA using transparency and disclosure as a regulatory tool;
• the proposed new power in relation to financial promotions; and
• the proposed new power in relation to warning notices.

• Transparency and disclosure

77. As a sector that regards fair treatment of customers as the top priority, we welcome the enhanced enforcement and redress approach of the FSA outlined in paragraphs 4.69-4.72. The BSA believes that the FSA has, following its supervisory enhancement programme, become a stronger conduct of business regulator. This is evidenced, among other things, by the increase in regulatory fines (from around £5 million in 2007 to about £89 million in 2010) and the recent use of its consumer redress powers.

78. In principle, we favour transparency and disclosure. For example, the BSA supported the publication, by the FSA and FOS, of complaints data, which began in late 2009 and through 2010. We recognise the point acknowledged in paragraph 4.76 of the CP that there have to be adequate safeguards in respect of confidential information.

• Financial promotions

79. The new powers envisaged for the FCA appear to be similar to the ‘stop now’ powers available to agencies such as the Office of Fair Trading and the Information Commissioner. The firm will have only a short time to make representations before the FCA finalises and publishes the notice. Because appeal to the Upper Tribunal will be available to the firm after the notice has been published, it is very important that the FCA uses this power only in cases where the advertisement is misleading beyond reasonable doubt. If a firm were to be successful in any appeal to the Upper Tribunal, the damage – in both commercial and PR terms – would already have been done.

• Warning notices

80. We have serious concerns about the proposed power for the regulators (primarily, the FCA – paragraph 4.88) to be able to publish the fact that they are proposing to take enforcement action. The CP states that “this will enhance consumer and industry confidence in the new regulatory system, and enable consumers to make more informed decisions”. We disagree. In our view, it is a strong, effective, fair and impartial regulator that would have that effect.

81. Since its supervisory enhancement exercise, the FSA has become a stronger and more credible conduct of business regulator. However, it has done so by a more
active programme of regulation, leading to final notices on significant regulatory breaches and penalties against firms that have been shown, on proper examination, to have breached FSA rules and/or principles. Its reputation will no doubt be further enhanced by judicious use of its strengthened consumer redress powers.

82. But advance publication of proposed enforcement action risks a new presumption of “guilty until proven innocent” in respect of regulated firms, which is unlikely to improve confidence in the regulatory system. The safeguards set out in paragraph 4.89 are inadequate – the first two rely entirely on the regulator’s discretion and the third is ‘after the event’; the reputational damage having already been done. As we understand it, the FSA often begins investigations that lead to no disciplinary action.

83. Our concern is that, as acknowledged in paragraph 4.89, once information about proposed enforcement action is published, reputational damage will be done to the firm, irrespective of the outcome of the action and without the firm having had recourse to an appeal process. While we acknowledge that such publication is technically not the same thing as a final determination of rights, it can have a very similar effect in terms of a firm’s reputation. Further, the firm will not have an opportunity to appeal to the Upper Tribunal or to the courts in the time available.

84. We believe that the Government should give serious consideration to the unintended consequences of the proposed measure, to the principles of natural justice and to the fundamental rights of the firms involved (please see the comments about firms’ human rights set out in reply to question 7 above).

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

85. We support, in principle, the proposed operational objective for the FCA in relation to competition – although it is welcome, we note that it falls short of the Treasury Committee’s recommendation of a primary statutory objective for the FCA of promoting competition. We believe that it is appropriate for the FCA to seek to promote competition, but the policing of anti-competitive practices should remain the role of the designated competition authorities.

86. Therefore, we urge the exercise of caution in introducing powers that potentially involve overlap between the FCA and the competition authorities. It is by no means clear that the FCA will have relevant ‘in-house’ expertise to make decisions regarding competition law. The recent consultation Reforming the Consumer Credit Regime was predicated on the removal of such regulatory institutional overlaps and a consistent position on such matters would be useful.

87. The BSA is examining the further consultation A Competition Regime for Growth, which deals with competition matters in detail and is considering whether to submit a response.

16 The Government would welcomes specific comments on:
• the proposals for RIEs and Part XVIII of FSMA; and
• the proposals in relation to listing and primary market regulation.

88. The BSA is relatively inexperienced in wholesale market matters and has few informed views on the proposals at the end of chapter 4 of the CP.
89. We broadly agree with the comments in paragraphs 4.101-107 to the effect that the FCA’s approach to the wholesale markets will differ from its retail supervision because there is often no immediate retail dimension – but, because (for example) products sold to retail customers may be based on instruments traded on the wholesale markets, the FCA will place appropriate and proportionate regulatory focus on the wholesale markets.

90. While the discussion about the UK Listing Authority (UKLA) is not closely related to the direct interests of financial mutuals, we would as a matter of principle prefer not to see a proliferation of regulators unless absolutely necessary – therefore, we support, in principle, the decision (set out in paragraph 4.110) to retain the UKLA as part of the FCA.

91. Most relevant stakeholders are agreed about the key importance of the UK regulators exercising as much influence as possible in the EU sphere in the UK national interest. Therefore, the assurances about strong UK representation (in paragraphs 4.117-4.118) are welcome.

**Regulatory Processes and Co-ordination**

17 What are your views on the mechanisms and processes proposed to support effective coordination between the PRA and the FCA?

92. The BSA welcomes the high-level principles for co-ordination, outlined in paragraphs 5.6, 5.8 and 5.10-11 of the CP. We particularly support the statement that “from the perspective of firms, coordination must result in regulatory and supervisory engagement that cost-effective and mitigate the risk of duplication”. As a principle, this is excellent, but it is important to clarify how it will be put into practice. The CP goes on to state that “the key to delivering effective coordination is to allow the PRA and FCA flexibility about how they engage with each other, rather than specifying onerous and bureaucratic processes in statute”. We understand this approach, but it leaves us no further forward in understanding how coordination will be achieved. Cross-membership of boards and memoranda of understanding, whilst important, are not mechanisms guaranteed to deliver co-ordinated processes.

93. Paragraph 5.10 of the CP states –

“The Government will set out clearly in primary legislation the legal responsibilities of each regulator. Where appropriate, this will include allocating specific responsibility for particular processes and regulatory decisions relating to dual-regulated firms or groups”

and paragraph 5.11 provides that –

“both regulators will be subject to a requirement to ensure that processes involving both regulators are managed congruently and efficiently. This would include, for example, taking steps to coordinate or combine supervisory activities to reduce unnecessary burdens on dual-regulated firms”.

94. The BSA strongly supports these approaches and, consistent with them, we urge the authorities to commit to a close examination of the certain specific measures (set out below) and, where practicable, their inclusion in the forthcoming legislation.

95. Paragraph 5.8 states that “The Government believes that the key to delivering effective coordination is to allow the PRA and FCA flexibility about how they engage
with each other, rather than specifying onerous and bureaucratic processes in statute”. We do not view the measures we propose as “onerous or bureaucratic processes” but, rather, sensible and reasonable practical ways of helping achieve key Government objectives for the new regulatory system. The measures are as follows -

(i) a common gateway for firms’ authorisations, approvals, variations, waivers, notifications, reporting etc– dual-regulated firms - ie all BSA members, banks, insurance companies etc - should not have to duplicate communications with the PRA and FCA

(ii) in particular, the ‘integrated regulatory reporting’ system (GABRIEL) should be maintained within the common gateway

(iii) sharing by the PRA and FCA of back-office functions, as the norm

(iv) retention of a single regulatory Handbook with one of the two regulators being the contact point in areas of potentially shared responsibility

(v) co-ordination between the PRA and FCA in respect of regulatory supervision/visits to minimise duplication for firms eg on informational requirements prior to regulatory visits

(vi) no overlaps between the PRA and FCA eg on material in discussions and consultations, thematic work, rule-making, provision of guidance, enforcement etc and there should be a senior Treasury official charged with ensuring that, while the regulators must of course actively co-ordinate, they do not allow any drift into a position where their functions overlap.

96. Regarding a common gateway, it would be far more practical and cost effective for the regulators themselves to manage the duplication inherent in the ‘twin peaks’ model than for each one of all the dual-regulated firms to be obliged to do so. We believe that a common gateway is an essential characteristic of properly coordinated regulatory arrangements.

97. Since 2006, the FSA has introduced GABRIEL with the laudable intention of simplifying and reducing duplication in regulatory reporting. This has, however, required considerable input from firms in terms of devising internal systems and reports in order to be able to provide the data items required. A large proportion of this information is financial and presumably will, in future, fall within the remit of the PRA as opposed to the FCA. The CP implies that the PRA and the FCA will have separate IT systems and, if so, presumably GABRIEL would not be used by the PRA as the method of submitting regulatory returns.

98. For firms to have to go through the process again with a view to submitting a different set of data to the PRA using a different system would seem to be contrary to the stated objective to ensure that “due regard is paid to value-for-money and cost-effectiveness considerations”. In this regard the BSA strongly recommends that there should be a common gateway for regulatory reporting and that so far as possible, it should be based on the GABRIEL returns, amended as necessary.

99. We strongly urge the Government to establish as the norm that the PRA and the FCA must share ‘back office’ functions. We note that, as illustrated in the FSA’s
transitional organogram\(^1\) effective 4 April 2011, FSA is now – by way of transition into the new regime – organised into a Prudential Business Unit (ie a shadow PRA) and a Conduct Business Unit (a shadow FCA) supported by a shared Operations directorate covering finance, HR, IT and facilities. This transitional structure will probably last for at least eighteen months. We do not see why, when the new successor bodies replace their shadows, the same shared back office arrangements should not in general continue. A failure to give serious consideration to the economies of them doing so where practicable would make a mockery of efficiency and value for money.

100. Regarding the regulatory handbook, we recognise that the PRA and The FCA will, respectively, be responsible for the subject matter covered by different modules, although some overlap is inevitable. However, we do not see why it should be necessary to dismantle and re-arrange the Handbook, with the re-writing that such processes would also no doubt entail, because of the twin peaks approach.

101. So far as regulated firms are concerned, there should continue to be a single regulatory handbook, albeit flagged to indicate which regulator is responsible for which module, rule etc. In case of overlap, one regulator should be designated to take lead responsibility.

102. The twin peaks approach inevitably means that dual-regulated firms will have to develop separate relationships with both the PRA and the FCA. Nevertheless, active co-ordination between the regulators could minimise overlaps in respect of many regulatory activities; for example, regarding information requests to firms, discussion and consultation papers, thematic work, enforcement etc. We believe that such coordination should be overseen by a senior Treasury official, who would be empowered to deal with failure of co-ordination.

103. The BSA believes that each of the coordination suggestions outlined above should -

- be included in the forthcoming legislation, or
- if the Government considers it impracticable to do so in the case of any particular proposal, it should commit to a full examination of how the relevant measure might be introduced in practice, or
- if the Government decides not to examine a particular measure, then a reasoned explanation should be provided as to why it is not considered appropriate to include the matter in the new regulatory architecture.

18 What are your views on the Government’s proposal that the PRA should be able to veto an FCA taking actions that would be likely to lead to the disorderly failure of a firm or wider financial instability?

104. The BSA agrees with the proposals relating to the management of the risk of disorderly firm failure. It is appropriate that the PRA should hold a veto over the FCA in the unlikely event of the two regulators being unable to agree, but we support the parameters placed on the veto.

19 What are your views on the proposed models for the authorisation process – which do you prefer, and why?

105. As noted above, the BSA firmly believes that there should be a common gateway for firms’ authorisations, approvals, variations, waivers, notifications, reporting etc. In light of the commitment towards regulatory coordination, contained elsewhere in the CP, it is disappointing that the only lead proposal in the CP relevant to specific regulatory processes is one that runs counter to such coordination.

106. We believe that dual-regulated firms should not have to apply to both the PRA and the FCA for permission. If the commitment to regulatory coordination is to be carried through in practice, this is an example of where a common gateway should be put in place ie allowing firms to make one application and for the regulators to take up the dual processing themselves. Accordingly, we strongly prefer the alternative approach set out later in chapter 5 (paragraphs 5.38 – 5.40).

20 What are your views on the proposals on variation and removal of permissions?

107. We are content to support the proposals, provided they can be achieved through a common gateway such as that described above.

21 What are your views on the Government’s proposals for the approved persons regime under the new regulatory architecture?

108. Again, we are broadly content to support the proposals, provided they can be achieved through a common gateway such as that described above.

22 What are your views on the Government’s proposals on passporting?

109. The proposals for regulatory responsibility and operation in respect of passported firms seem appropriate.

23 What are your views on the Government’s proposals on the treatment of mutual organisations in the new regulatory architecture?

110. The BSA, and the financial mutual organisations it represents, seek no special favours and, therefore, we agree with the fundamental position set out in paragraph 5.54 –

“The Government is clear that neither regulatory authority should seek to promote or favour one type of ownership model over another, and that consumers should not be advantaged or disadvantaged because of the ownership model of their provider. The same consumer protection, conduct and prudential standards must be applied to every regulated firm, regardless of their ownership model.”

111. However, mutuals do seek a genuinely level playing field and object to unfair competition. During the financial crisis from 2007, large incumbent plc banks benefited disproportionately from the intervention of the authorities, and some continue to enjoy State backing. In addition, those deposit-takers that had not relied excessively on wholesale funding, in the way (for example) that Northern Rock did, were unfairly prejudiced by the FSCS funding model, so that their prudence counted against them in the bail-outs of the Icelandic banks and Bradford & Bingley.
112. It is one thing to make assurances about equal, or fair, treatment, but it is crucial that discrimination against specific business models does not persist in practice under the new regime; for example, the definition of core capital in the regulatory requirements should allow instruments that are consistent with mutual ownership.

113. The proposal about cost-benefit analyses is welcome, but – tested against the substantial examples of unfair discrimination highlighted above – it is insufficient to ensure a level playing field for financial mutuals and less than included in the last CP. As we explained in detail in our response, the BSA believes that the FPC, the PRA and the FCA should each have a specific statutory remit consistent with, and in discharge of, the Government’s policy of encouraging financial diversity. There should be a senior member of staff, in both the PRA and FCA, with a specific remit of ensuring that diversity, including the particular position of mutuals, is fully taken into account when these new bodies consider regulatory action.

114. However, as noted above, we recognise that such an approach may be integral to the requirement for proportionality; the CP states (paragraph 4.25) “Proportionality also means that the regulator must tailor its actions to the specific characteristics of the sector being regulated.” We would welcome confirmation that our interpretation is correct.

115. Regarding the location of registry functions, we have no strong views but are inclined to agree with the CP that the function is more of a prudential than conduct nature and is probably better located at the PRA. As to the registration arrangements for non-financial mutuals, while we agree with the CP that it seems inappropriate for their registration to be dealt with by a financial services regulator, we suggest that the Government should re-engage with leading representatives of non-financial mutuals, especially Mutuo and Co-operatives UK, with a view to finding a satisfactory alternative.

116. The BSA welcomes the legislative amendments referred to in paragraph 5.58, on which we have worked with HM Treasury. The flexibility regarding payment and settlement systems is particularly needed as societies will need to engage more and more with such systems, both in respect of securities and derivatives. The reference to ‘shareholders’ is technically correct under the building societies legislation, but we note for information to readers of this response that, in the building society context, the term refers to ordinary savers whose “share accounts” confer membership of the society. Building societies do not, of course, have PLC-type shareholders.

24 What are your views on the process and powers proposed for making and waiving rules?

117. As noted above, the BSA believes that there should be -

- a common gateway for firms' authorisations, approvals, variations, waivers, notifications, reporting etc in dual-regulated firms, including the ‘integrated regulatory reporting’ system being maintained within the common gateway

- retention of a single regulatory Handbook with one of the two regulators being the contact point in areas of potentially shared responsibility.

Provided the proposed arrangements are accommodated within the above mechanisms, we support the proposals.
The Government would welcome specific comments on
• proposals to support effective group supervision by the new authorities
  – including the new power of direction; and
• proposals to introduce a new power of direction over unregulated
  parent entities in certain circumstances?

The BSA recognises that these matters are now largely governed by EU
directives (paragraph 5.66), which seem very complicated, so we have no comments
to make on proposals that broadly reflect that governance. The BSA has little direct
interest in the point about unregulated holding companies, but we observe that the
CP provides no detail about what matters a power of direction would deal with.

What are your views on proposals for the new authorities’ powers and
coordination requirements attached to change of control applications and Part
VII transfers?

The proposals seem to be sensible.

What are your views on the Government’s proposals for the new
regulatory authorities’ powers and roles in insolvency proceedings?

As far as our members are concerned, the arrangements appear to be based
largely on legislative requirements, so we have no comments.

What are your views on the Government’s proposals for the new
authorities’ powers in respect of fees and levies?

We welcome the assurances about effective coordination and consideration
of the impact on firms, especially those that are dual-regulated and, in particular, the
small, dual-regulated firms. The proposals for collection of the fees appear to be
sensible.

The crucial point is that the regulators exercise careful control over costs. As
noted above, we believe that - apart from transitional costs - an overall cap on the
first year budgets of the PRA and the FCA should be introduced, which should be no
higher than the current FSA budget (and clear controls be put in place on levels of
future budgets).

As noted earlier in this response, the FSA’s supervisory enhancement
process significantly inflated the FSA budget. While we supported the process and
believe that it has been executed efficiently, it means that the new regulatory
arrangements will start from an already high cost base. Even regulators should not
be immune from the need to control costs, especially in a difficult economic climate.

Compensation, Dispute Resolution and Financial Education

We believe that FOS is fast approaching a crossroads where its future
arrangements will depend on whether or not it continues to be required, in effect, to
‘quasi-regulate’ mass claims. We set out more detailed comments below, in
response to the CP questions.
29 What are your views on the proposed operating model, coordination arrangements and governance for the FSCS?

125. The BSA supports the proposals that the PRA should take on the FSA’s powers and responsibilities in respect of the FSCS and that the FCA should assume the equivalent responsibilities regarding the FOS and MAS (formerly known as CFEB). These proposals are consistent with the, respective, prudential and conduct of business responsibilities of the PRA and the FCA.

126. We agree with the Government’s decision to retain the FSCS as a single organisation to administer compensation – it is right that there should be a separate body with this role; it is not appropriate for one of the regulators to assume such responsibility.

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

127. We agree with the statement in paragraph 6.19 that the Ombudsman’s statutory functions and objectives are, and should remain, distinct from those of the regulator. This is entirely appropriate because FOS is meant to be an adjudicator of individual complaints and should be able to conduct that role in an independent manner, free from interference. We support the other measures (outlined in paragraphs 6.20 and 6.21) concerning co-ordination between FOS and the FCA. The BSA also welcomes the proposal for greater transparency regarding FOS determinations.

128. These comments disregard the quasi-regulatory effect of Ombudsman decisions in the so-called ‘wider implications’ (WI) or ‘mass claims’ cases. As far as such cases are concerned, FOS is increasingly part of the continuum that runs through the regulatory and complaints system – the proposal to require FOS to pass certain information to the FCA (paragraph 6.20) underlines this point.

129. The BSA believes that the WI arrangements for dealing with such matters, despite attempts to enhance them over the years, were not a success and we will not mourn their passing (mentioned in FSA Feedback Statement 11/2, in late March 2011). As the CP states, the new tools available to the FSA – especially the section 404 FSMA powers – could, if used properly, have a significant effect and allow FOS to focus on what it was set up to do – ie deal with individual complaints. Indeed, the question might reasonably be asked – should FOS continue to be expected to deal with ‘mass claims’ type cases or should it now be allowed to return to its original function?

130. We believe that FOS is fast approaching a crossroads. If it is to continue to be expected to deal with mass claims and is to be increasingly linked, in respect of policies and practices, with regulatory processes then a radical overhaul of its activities and accountability, and also its lack of an appeal process, may well be unavoidable.

131. We recognise that a joint FSA/OFT/FOS statement on claims management companies (CMCs) is due later this year, but we are disappointed at the lack of reference in the CP to the significance of CMCs in relation to FOS and to complaints generally. Last year, 28% complaints were made to FOS on behalf of consumers by CMCs. In our view, their prominence and impact now justifies CMCs –
being regulated to the same level of conduct of business standards and enforcement as FSA-regulated firms, and

- like FSA-regulated firms, making a financial contribution to FOS.

132. The most recent consultation by FOS on its plan and budget [www.financial-ombudsman.org.uk/publications/pb11/pb11-1.html](http://www.financial-ombudsman.org.uk/publications/pb11/pb11-1.html) confirms that “Mass claims are usually driven by internet campaigns, claims-management companies and publicity in the media”. Some of our members have provided the BSA with evidence that certain CMCs are taking active steps to prevent their clients from communicating with the firm being complained about and seek to push complaints through to the Ombudsman with no serious commitment to mediation. Such practices would be contrary to the forthcoming guidance in the FSA Handbook on handling PPI complaints (PS 10/12) –

DISP 3.3.4G – The firm should make all reasonable efforts (including by contact with the complainant where necessary to clarify ambiguous issues or conflicts of evidence before making any finding against the complainant.

133. There is a negligible cost for the CMC in such a modus operandi, but the firm must usually pay a case fee even if FOS reject the complaint (unless FOS decides that it is frivolous or vexatious – in practice only a very small percentage: see below). These organisations usually charge consumers fees or commissions, sometimes in the order of 35% of the ultimate award (if any). The FOS annual review 2009/10 states –

“We are a free service for consumers, while commercial companies charge consumers to bring a complaint on their behalf. And our procedures are designed to be simple for consumers to use. We decide cases by looking at the facts – not at how well the arguments are presented. We prefer to hear from consumers in their own words.”

We decide cases by looking at the facts – not at how well the arguments are presented. We prefer to hear from consumers in their own words And in our experience there is no difference in the outcome of complaints – whether consumers bring them to us themselves direct, or whether they pay a claims-management company to complain on their behalf.”


134. For several thousands of members of the public to be paying for a service, which according to FOS – overall – leads to no difference in the outcome of complaints, cannot possibly be in the interest of consumers. The current situation is no longer sustainable and the BSA is working with other trade bodies towards possible representations in favour of rule changes in respect of CMCs. These might include, for example, the implementation of the Hunt Review recommendation that, as businesses, CMCs – but not consumers – should be required to pay a case fee.

31 What are your views on the proposed arrangements for strengthened accountability for the FSCS, FOS and [MAS]?

135. The BSA welcome the plans, outlined in paragraphs 6.27-6.28 regarding the accountability of the FSCS, FOS and MAS. We particularly support the proposal that the National Audit Office should be responsible for auditing these bodies. At any
time, but especially at a time of recession, it is crucial that publicly or industry-funded bodies provide good value-for-money.

136. There is a further dimension to FSCS’ accountability on which we commented earlier in this response. While supporting a statutory requirement for FSCS to publish and consult on its Annual Plan, we also insist on a stronger voice for banks and building societies as levy-payers into the deposit-taking side of the FSCS in relation to any major use of its funds to finance a bank resolution (cf Bradford & Bingley, Icelandic banks). In those situations, FSCS, as the principal creditor in the wind-down of the rump banks, should be overseen by a creditor’s committee representing the deposit-takers who are footing the bill.

137. While the BSA fully respects the importance of the independence of FOS in its role as an adjudicator of individual complaints, it has long-standing concerns about the lack of accountability at FOS in respect of wider implications-type cases – see, for example, our response as long ago as 2004 to the FSMA 2 Year Review www.bsa.org.uk/policy/response/100557.htm. In principle, our concerns remain but, as noted above, the consumer redress powers now available to the FSA are capable of addressing some of the difficulties posed by wider implications cases. Also as noted above, the question of accountability of FOS increasingly turns on whether the organisation is to be simply an adjudicator of individual complaints or whether it is also, in effect, to be expected to quasi-regulate mass claims.

138. We believe that there is one modest development in respect of FOS that could be set in train immediately. Firms usually pay a case fee of £500, unless the Ombudsman rejects the complaint on one of certain grounds specified in the Dispute Rules (‘dismissal without consideration of the merits’). One of the grounds is that a complaint is ‘frivolous or vexatious’. The FOS annual review 2009/10 addresses the matter as follows –

“of the 166,321 complaints we settled during the financial year 2009/10, we concluded that 702 cases (0.4% of the total) could be categorised in that way. 677 of these cases were complaints – mostly brought by claims management companies – relating to payment protection insurance (PPI) policies that had never been taken out. We do not charge a case fee to the business complained about where we decide that a complaint is frivolous and vexatious.”

139. It is clear from this that the vast majority of cases deemed to be ‘frivolous or vexatious’ are cases where the firm complained about had not sold the product in the first place. Only 25 of 166,321 complaints settled last year (0.01%) that were determined to be frivolous and vexatious were categorised as such for other reasons – we understand that some of those were frivolous or vexatious because they were ‘duplicate’ complaints.

140. In view of this tiny number in contrast to the fairly broad range of situations covered by the terms ‘frivolous’ and ‘vexatious’, the BSA believes that it would be appropriate for a review to be put in place of FOS’s processes for determining whether or not a case is frivolous or vexatious.

European and International Issues

32 What are your views on the proposed arrangements for international coordination outlined above?
141. We welcome the measures to help ensure proper coordination with the EU and internationally. It is crucial for the UK economy that our regulators are fully involved. The table earlier in this response is limited to conduct of business measures, and does not extend eg to prudential matters, but it still emphasises the substantial contribution made by the EU to UK regulation.

142. It needs to be recognised that much, perhaps most, micro-prudential policy (eg on capital and liquidity) is now settled at EU level with the UK having less and less room for independent manoeuvre. Increasingly, this is also true of conduct of business regulation. So - in future - at least as important as consultation on actual rules and guidance will be consultation on the agreed outcomes that the UK should seek from current and future EU regulatory initiatives, which will then inform the UK negotiating strategy. (As explained above - see response to question 23 - this should include a level playing field for UK businesses of different corporate forms.)

143. This illustrates moreover a fundamental flaw in the FSMA consultation requirements which could have been foreseen before 2001, but is now even more manifest. Where, for instance, a piece of micro-prudential policy is agreed at European level by way of a maximum-harmonising Directive, and FSA has to implement this by way of making rules, it must still go through a meaningless and pointless charade of consultation even though the European legislation must be implemented without amendment or super-equivalence. But at the point where consultation and cost-benefit analysis might actually have added some value – i.e. before settling on the policy position which the UK would advance in European negotiations – there is no requirement to do so.

144. We suggest that this lacuna be addressed as follows - there should be a standing requirement for the Treasury, PRA or FCA as the case may be, to carry out both consultation and cost-benefit analysis on any proposal for European legislation in order to establish what negotiating position actually represents the UK national interest. Informal soundings are simply not robust enough.

145. It is imperative that the UK regulators coordinate closely with the European authorities in order to –

- represent the UK interest – UK regulators will no doubt understand the need to ensure that their divided roles must not be allowed to reduce the strength of UK representation in the EU regulatory framework, and

- avert further episodes of legislative ‘front running’ ie where UK agencies introduce new laws and rules, which then have to be unravelled because of the implementation of EU legislation that was already in the pipeline when the UK exercise began (consumer credit legislation is a clear example of this practice, which is very unhelpful to the UK economy – see www.bsa.org.uk/policy/response/response_hmt_bis.htm). It would be most welcome if, in addition to its very helpful recent commitment against ‘gold-plating’ of EU law, the Government could also commit to ending the damaging practice of ‘front-running’.

The Building Societies Association
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