12 April 2011

Our ref: ICAEW Rep 42/11

Your ref:

Financial Regulation Strategy
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Dear Sir or Madam

A new approach to financial regulation: building a stronger financial system

ICAEW is pleased to respond to your request for comments on your consultation paper on *A new approach to financial regulation: building a stronger system*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours faithfully

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ICAEW REPRESENTATION

A NEW APPROACH TO FINANCIAL REGULATION

Memorandum of comment submitted in April 2011 by ICAEW, in response to HM Treasury consultation paper *A new approach to financial regulation: building a stronger system* published in February 2011

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation paper *A new approach to financial regulation: building a stronger financial system* published by HM Treasury.

WHO WE ARE

2. ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. We ensure these skills are constantly developed, recognised and valued.

MAJOR POINTS

General comments

4. Overall we welcome the Consultation Paper (CP). It helpfully develops the proposals set out in the Treasury's earlier CP on a new approach to financial regulation (July 2010), providing considerably more detail on how the new structures should work. ICAEW understands and recognises the pressures for change.

5. We particularly welcome the intention to establish macro-prudential machinery, and to emphasise judgement and proportionality in regulation.

6. Any significant mismatch between what society expects and what the financial regulatory system is designed to deliver has the potential to lead in due course to accusations of regulatory failure and further to undermine trust in the financial system. In subsequent documents connected to the reform process it might be wise to include some explicit discussion of what the Government believes society expects from its regulatory system.

7. We also believe that the proposals could be set more firmly within the context of international, and especially European, developments. For example, as we note below, our understanding is that development of micro-prudential policy will increasingly be moving to the European authorities responsible for banking and insurance / occupational pensions, and that these bodies will pursue a common 'EU rule book'. On the face of it, this seems likely to constrain the scope in future for some types of unilateral action on micro-prudential regulation by the UK.

8. It may also be helpful for the authorities to set out the lessons they believe arise from the experience of countries which have operated a 'twin peaks' approach for some time, such as Australia and the Netherlands.

Financial stability

9. While we welcome giving the Bank of England tools with which to pursue financial stability, we believe that caution will initially be required in the deployment of macro-prudential instruments. There is little recent experience of their use, and analytical frameworks to underpin their operation are still in their infancy. It will be important to be alert to possible unintended consequences.

10. Challenges will also arise to the extent that there is less than full reciprocity regarding macro-prudential policy. Where additional requirements are applied to UK firms, there will be a tendency for business to move to foreign firms and/or outside the regulatory perimeter. However, the retail financial services market in the UK remains largely 'local', and that should underpin the effectiveness of macro-prudential policies targeted at retail business (eg mortgage lending).

Approaches to regulation

11. We strongly believe that the substance of regulatory activity, and its effectiveness, are much more important than formal structures. It is essential that throughout the transition to the new approach there continues to be a strong focus on filling out exactly how it will be made to work in practice. The current FSA and other authorities should consult on this important material well ahead of the new structure going live.

12. We agree that judgement is very important in regulation. It should be exercised within the context of systems at the regulators which are sufficiently strong to deploy it in a way which is well informed, proportionate and consistent across firms and markets. To that end, we recommend that careful attention continues to be paid to governance and accountability mechanisms. In particular it may be appropriate for the PRA and FCA to establish Quality Assurance functions to provide an independent internal assessment of how judgement is being applied. It is crucial that the governance and accountability mechanisms are set up in a way which is supportive of those being called upon to exercise judgement, for otherwise regulators could become excessively risk averse.

13. ICAEW is aware that some in the insurance industry are concerned that the Bank of England group may not pay sufficient attention to insurance issues given that historically the focus of the Bank has been on banking business. It will be important to allay these fears, especially given that the timing of moving to the new approach will be roughly the same as that for adoption of Solvency II.

14. Regarding retail conduct regulation, ICAEW believes that it is necessary to analyse why retail regulation has not met expectations in the last 25 years or so as key background to developing more effective approaches. An important debate about objectives and how best to achieve them has been initiated in particular by the FSA's recent Discussion Paper on *Product Intervention*. We would caution against prejudging the result of that dialogue.

15. We would also stress the importance of the FCA being structured in a way which fosters appropriate focus on all of its functions. In that context, we welcome the proposal in the CP to establish a Markets Panel on a statutory basis.

Operational issues and the transition

16. The CP contains numerous references to the PRA being able to veto decisions of the FCA in various circumstances. We believe this risks creating the impression that prudential considerations are more important than conduct ones. In our opinion, actions by the FCA in respect of conduct issues would be likely to threaten the disorderly failure of PRA regulated firms, or financial stability, only in rare circumstances. We therefore suggest explictly setting a high bar to the use of the PRA's veto. That would help to underpin the credibility of the FCA with market participants and others at home and overseas.

17. The authorities should be alert to signs of potential overload in the new system. One example is the proposal that the Governor of the Bank of England should, in addition to his duties at the Bank itself and at the MPC, take on the chair of both the FPC and the PRA. This example points to the importance of the different bodies within the new approach having well-designed schemes of delegation within them.

18. In our opinion the new regulators should consider whether for routine functions it would be most efficient if there was a single entity which would provide services, such as collecting regulatory returns, on an outsourced basis to both the PRA and the FCA. Given that the majority of firms by number will be regulated by the FCA, for administrative purposes such a provider could be a subsidiary of the FCA.

19. No specific question is posed with regard to the proposed power to disqualify individual actuaries and auditors (paras 5.92 – 5.97). However, we do not think such a power is necessary with regard to matters arising out of audit work. For auditors, there are existing arrangements to deal with this, maintained by the Recognised Supervisory Bodies for audit and the Financial Reporting Council (FRC).

20. The FSA already has the ability to refer concerns about the performance of individual auditors and actuaries to the FRC's Accountancy and Actuarial Discipline Board (AADB), where matters of public interest arise and a disciplinary investigation is needed. The FSA had not made wide use of this power before the financial crisis, although we are aware that a few cases in respect of client assets have been referred to both the FRC and the Recognised Supervisory Bodies, which are under current disciplinary investigation. The Recognised Supervisory Bodies already have the powers to disqualify individual auditors, either from auditing entirely or from a class of audits. However, such decisions can only be made if appropriate evidence is provided by the FSA and due process, including the right of appeal, is followed. ICAEW's processes are overseen by the FRC's Professional Oversight Board. Overall, we therefore do not think the case for new powers, to the extent that they would apply to audit work, has been established.

21. Regarding the transition, it is widely acknowledged that there are numerous risks, both for the regulators, particularly potential loss of high-quality FSA staff, and regulated firms, which at present do not have sufficient detail in order to prepare for the new arrangements. We urge the authorities to promulgate a reasonably detailed transition plan as soon as possible.

22. We note that high ability and/or considerable experience are likely to be prerequisites if front-line regulators are to have the skills to deliver genuinely judgement-led regulation. That has implications for remuneration and the costs of the regulatory system both through the transitional period and beyond, which needs to be borne in mind in planning the likely shape of the PRA's and the FCA's finances.

RESPONSES TO SPECIFIC QUESTIONS

Q1: What are your views on the likely effectiveness and impact of these instruments as macro-prudential tools?

23. The FPC should take into account the fact that financial innovation is likely to be prompted by the use of these instruments. To the extent that a regulatory instrument imposes a binding constraint on private sector portfolio choices, an incentive to work round it is created. That would reduce the effectiveness of such instruments, and is something which will need to be borne in mind in calibrating the extent to which the instruments are deployed (eg the magnitude at any given time of a counter-cyclical capital buffer).

24. More broadly, some 'leakage' in the effectiveness of the instruments is likely to the extent that macro-prudential policy was operated on a UK-only basis. There is a risk that restrictions which bite on UK-authorised firms could be undermined to some degree by the activities of foreign firms not subject to UK prudential rules (eg branches of EU banks operating in the UK). However, to a considerable extent retail financial markets in the UK are still 'local', so we would expect macro-prudential instruments targeted at retail business (eg mortgage lending) to be quite effective.

25. An important challenge in using the instruments counter-cyclically is being able to reduce requirements in downswings. Market pressures, especially in times of clear stress, might make that difficult in practice. For example, under stressed conditions market participants might draw comfort if 'high' levels of bank capital had been built up in a previous, benign period – and might be reluctant to see bank capital falling even if there was a clear macro-prudential rationale for that. Very clear on-going communication by the FPC to the market (and the public generally) would help to mitigate this risk.

26. We agree with the Government that the FPC's tools must be ones for which there is sufficient national discretion. In particular, we welcome the recognition (para 2.45) that accounting standards for listed companies are those determined internationally by the International Accounting Standards Board (IASB), as adopted by the European Union. This means that it would not be possible for the FPC to alter the principles underlying company annual and interim financial statements.

Q2: Are there any other potential macro-prudential tools which you believe the interim FPC and the Government should consider?

27. We have no comments on this question.

Q3: Do you have any general comments on the proposed role, governance and accountability mechanisms of the FPC?

28. Given that the instruments available to the FPC are largely untested in recent UK experience, we believe that a judicious approach should be taken to their use. We therefore very much agree with the CP (para 2.49) that the FPC should be required publicly to set out its rationale when any instrument is used and the impact sought, and to establish a mechanism for ongoing ex post evaluation of the effect in practice.

29. We believe that it is important that the FPC has at least two members with recent top-level experience in the financial sector. This will assist the FPC in gathering and assessing market intelligence and in analysing the full implications of possible actions to promote financial stability. The CP takes the same view (para 2.78). We are therefore somewhat concerned that very few members of the interim FPC appear to have relevant private sector experience.

30. We support the suggestion that the Government should look at making provisions regarding management of any conflicts between the resolution authority and the prudential regulator regarding crisis management (para 2.152). It is conceivable that conflict could arise given that the PRA and the resolution authority will have separate boards of directors.

Q4: Do you have any comments on the proposals for the regulation of systemically important infrastructure?

31. Given the division of responsibility envisaged between the Bank and the FCA for regulation of this core infrastructure, as the CP recognises close co-ordination between these bodies will be essential – not least in relation to UK representation in ESMA.

Q5: What are your views on (i) the strategic and operational objectives and (ii) the regulatory principles proposed for the PRA?

32. We broadly agree with the objectives and principles as set out in the CP.

33. It will be important to ensure that the strategic objective of financial stability, and the principle of proportionality, does not lead in practice to insufficient attention being paid to smaller deposit takers and insurance companies. This is partly a matter of ensuring that they are subject to effective prudential supervision but also ensuring that they receive sufficient support in meeting regulatory requirements, bearing in mind the more restricted resources of smaller firms. It would not be desirable if the market attached a higher risk premium to smaller firms because of a perception that they were subject to less effective regulatory oversight.

34. The PRA should establish and maintain rules appropriate to firms of all sizes and levels of sophistication for which it is the prudential regulator, including simplified approaches for smaller or less sophisticated entities (to the extent this is possible under the relevant EU Directives).

35. The unqualified reference in the PRA's objective of 'safety and soundness' could be taken as something close to a 'zero failure' regime. For the avoidance of doubt it might be appropriate to include explicit reference to allowing firms to fail in the regulators' objectives and/or the regulatory principles.

36. We strongly agree with the principles relating to the regulators being as transparent as possible, including making information on authorised firms and recognised exchanges available in appropriate cases. However, we would stress the importance of the primary legislation requiring that decisions on publication of information on specific entities, or particular individuals, have full regard to their legitimate rights. The regulators would need to be mindful of the likely impact on a firm's / individual's reputation of any publication before an issue had been finally determined.

37. Given that the FCA will be setting some prudential rules, including for a limited number of 'prudentially significant' entities, in our view care will need to be taken to ensure that the two sets of prudential rules are consistent to the extent that is appropriate, bearing in mind the different types of entity to be regulated by the PRA and the FCA. Close co-operation between PRA and FCA policy staff should ensure this.

Q6: 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?

38. We strongly welcome the recognition (para 3.22) that the special charateristics of insurance should be taken into consideration in designing the regulatory approach which applies to insurance companies.

39. We also welcome the principle that investment firms would be designated only where they pose risks which can be mitigated through prudential regulation. In designating firms, the balance between objective criteria and judgement is not made entirely clear in paras 3.24 - 3.26. While accepting that an element of judgement will be required, as the consultation paper acknowledges this should be exercised within a clear framework of published principles, and be subject to proper due process.

40. ICAEW is aware that some investment firms are concerned that they are, at present, unclear whether they will fall under PRA regulation or not. It would help to reduce uncertainty in the market if more information on the likely designation criteria could be promulgated as soon as possible. This information would also throw light on whether or not there is a risk of significant numbers of investment firms potentially migrating into and out of the scope of PRA regulation over time if there are changes in their business model or other relevant factors.

41. Given the scope for innovation in finance, it is important that the perimeter of regulation generally can be altered fairly quickly should the FPC conclude that is necessary in order to protect financial stability.

Q7: 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 more limited grounds for appeal)?

42. We believe that judgement is a key feature of an effective regulatory regime. However, it is essential that such judgements are made within a well-defined, published regulatory

framework. It should be possible to appeal not only on points of law but also on the substance of a significant regulatory decision.

43. It may prove challenging to take enforcement action on the basis of 'purposive' interpretations of the regulatory rules, as opposed to evidence that one or more rules were not complied with. One reason is that there could be a substantive difference of view between a regulated firm and the PRA as to whether the purpose of a rule had been met or not, particularly in complex situations in which, for example, it might be arguable that a range of different actions taken together had adequately met the purpose. This is an area where further dialogue with the legal community could prove helpful.

44. In view of the untested nature of these legal arrangements, as well as the proposed concentration of powers in the Bank of England group, we consider that it would be inappropriate for the grounds for appeal to be narrowed at the present time.

Q8: What are your views on the proposed governance framework for the PRA and its relationship with the Bank of England?

45. The CP states that the PRA board should 'perform a robust challenge function' (para 3.47). In that context, we believe it would be appropriate for the power to make appointments of non-executive directors to the PRA board to be vested specifically in the Court of the Bank of England, as opposed to the Bank more generally. The Court would bring a diverse range of backgrounds and experience to bear on making these critical appointments.

46. In view of the emphasis being given to judgement-led regulation, we believe that the legislation should require the PRA board to establish an independent Quality Assurance function the key purpose of which would be to review whether judgement is being applied appropriately and consistently. (We would recommend that the FCA also establishes a Quality Assurance function).

47. It is not entirely clear why approval of the PRA's remuneration policies for staff – as opposed to the overall budget – should be reserved to the Court of the Bank (para 3.43). The impact assessment states (page 117) that there is an expectation that costs of prudential regulation will fall in the medium term following, amongst other things, adoption of the 'new judgement-based regulatory model'. We would be concerned if that were to be delivered through curtailing remuneration of regulatory staff in a way which had an adverse effect on the recruitment and retention of high quality employees. The complexity of modern finance means that it is essential that a significant proportion of regulatory staff have appreciable private sector experience.

Q9: What are your views on the accountability mechanisms proposed for the PRA?

48. We support the mechanisms proposed in the CP.

Q10: What are your views on the Government's proposed mechanisms for the PRA's engagement with industry and the wider public?

49. We agree with the Government's view that there should be no significant reductions to the exisiting requirements to consult as set out in FSMA (para 3.66). In our view, consultation about proposed rules is particularly important, both as a mechanism for the regulator to benefit from the insights of stakeholders, and also because of the legal status of these rules.

50. It is not clear to us why the CP suggests giving the PRA very considerable flexibility in deciding how to engage with practitioners and the wider public. This aspect is an important one in terms of the effectiveness of regulation and 'checks and balances' in the system, and we would be more comfortable if minimum requirements were set out in primary legislation. We are aware of a certain amount of dissatisfaction on the part of market participants that the future of the existing FSMA Panels in relation to the work of the PRA is unclear at present.

51. Amongst others, the PRA will need to engage closely with auditors (as already set out in the FSA's draft Code of Practice for the relationship between the external auditor and the supervisor, February 2011). In that context, in our view in addition to the existing legal duties under FSMA for auditors to report to the FSA on certain matters, we believe that the revised financial regulation legislation should place a duty on the PRA and the FCA to communicate to a regulated firm's statutory auditor any information that is likely to be materially relevant to their audit work. That would be consistent with Principle 3 of the Code, where it is stated that: 'the presumption should be that the supervisor will want to share any information it has that is likely to contribute to higher quality audits'.

Q11: What are your views on (i) the strategic and operational objectives and (ii) the regulatory principles proposed for the FCA?

52. We consider the objectives and principles to be broadly appropriate. However, we would prefer to see a more explicit focus on making the retail market work as well as possible for consumers. Achieving that will require a careful analysis of the shortcomings at present. In our view, it is not clear that a major issue is a lack of 'efficiency and choice' and we wonder whether that is appropriate as one of the operational objectives. The single most important problem is probably the asymmetry of information between producers and consumers.

53. It is not clear that it is appropriate for a 'small population' of 'prudentially significant' firms (Box 4.E) to be regulated by the FCA. If they are 'prudentially significant' they are likely to have some capacity to pose a systemic risk, and so would fit more naturally into the PRA. The fact that the PRA will possess most of the expertise on prudential issues within the UK regulatory system points in the same direction.

54. We are concerned that it is not proposed that the FCA should be given an operational objective of reducing financial crime (even – apparently – as part of the 'integrity' objective), and indeed by the limited attention to this subject in the CP. Economic crime can have very corrosive long-term effects on economic efficiency, and it is important that the subject receives proper attention. The FSA has recently had some notable successes in this sphere, and this momentum should not be lost.

55. In view of the proposals that anti-money laundering and market abuse cases should be handled by the FCA, we are not entirely sure what role the proposed Economic Crime Agency will play. We also note that Box 4.C (page 66) does not set out information-sharing and gateway arrangements among the rather numerous agencies which deal with facets of financial crime.

56. In line with the thrust of recent FSA initiatives, greater emphasis should be given to protection of client assets. This function of the FCA is critical – from the viewpoint of consumer protection in normal times and facilitating resolution of firms threatened with insolvency (which is greatly complicated if client assets are not properly segregated).

Q12: What are your views on the Government's proposed arrangements for governance and accountability of the FCA?

57. These seem to be largely modelled on those of the FSA, and in themselves do not raise any particular issues. However, we believe that the governance and accountability mechanisms should be framed in a way which will ensure that sufficient attention is paid to all of the main types of regulatory activity in the FCA. In view of the global significance of the wholesale financial markets in the UK, it is particularly important that markets regulation is given appropriate prominence. We therefore welcome the proposal to establish a Markets Panel on a statutory basis (para 4.39).

Q13: What are your views on the proposed new FCA product intervention power?

58. The CP includes quite extensive discussion of actions, such as product bans, which could be seen as prejudging the FSA's recently issued Discussion Paper on *Product Intervention*. We recommend that the Treasury takes full account of responses to that DP when available.

59. The possibility of product bans in particular raises some fundamental issues. For example, a power to ban specific products likely to cause significant consumer detriment could inadvertently create an impression that the FCA will proactively examine all products on sale to the retail market – to check whether they should be banned. The Treasury and FCA will need to consider how best to lean against such an expectation developing. That said, we believe a case may exist for well targeted product bans – we are aware of some products which have been marketed to consumers that were unlikely to be suitable for almost any client.

60. The strong nature of the product intervention powers envisaged suggests that the relevant framework should perhaps be set out in primary legislation rather than in FCA rules (para 4.64). In our view there are some emerging indications that the FCA might in some way become involved in regulating the pricing of retail products. Given that this would be a major step to take, were it the intention that should also be made explicit in primary legislation.

Q14: 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.**

61. As stated above in the case of the PRA, we support appropriate transparency and disclosure, so long as the rights of firms and individuals are properly respected. In particular, we believe that publication of warning notices before a final determination would be unjust, because publication has the potential to lead to serious reputational damage to a firm. It is important that regulatory processes substantively preserve the presumption of innocence until due process is completed and an adverse conclusion is reached.

Q15: 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?

62. We agree with the emphasis given to fostering competition, and are sympathetic to addressing competition issues more quickly. There are some markets – for example aspects of retail banking – where it is widely felt that stronger competition would be highly desirable. However, we note that the Government is reviewing the competition regime more generally, so it is difficult at this point to envisage how the FCA could best contribute to competition policy.

63. In our view it would not be appropriate for the Consumer Panel to have the ability to trigger a super-complaint process. This would not be consistent with the Panel's role in providing independent oversight of the FCA's policy development and regulatory activity from the perspective of consumers.

Q16: The Government would welcome specific comments on:

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

64. We have no comments on this question.

Q17: What are your views on the mechanisms and processes proposed to support effective coordination between the PRA and the FCA?

65. Effective co-ordination between the PRA and the FCA will be essential – bearing in mind that all authorised firms will be subject to the FCA.

66. The CP deals mainly with co-ordination at a very senior level and on major issues. But it will be just as important that there are close links between the staff in the two organisations at every level. There is a danger that over time the two regulators will tend to drift apart, due to factors such as the rather different subject matter they will deal with, and the possibility of some 'cultural' differences emerging between them.

67. We believe further proposals should be developed as to how a culture of co-operation can be embedded throughout both the PRA and FCA. This is partly a matter of 'tone at the top', but some specific mechanisms could help too. For example, the PRA and FCA boards could meet jointly from time to time on an agreed schedule, and they could establish a public forum where they would meet representatives of dual-regulated firms to discuss how well co-operation appeared to be working in practice. Co-operation could also be a specific subject considered in the annual reports of the PRA and the FCA.

68. In terms of day to day working, it would probably be helpful for the PRA and FCA to put in place arrangements for cross secondments of staff – though to make an appreciable difference to co-operation, the number of staff who had been seconded for a period would need to be a significant proportion of the total.

69. From an efficiency and economy perspective in relation to the resources of both regulators and firms it will be important for the PRA and FCA to develop working practices which encourage each of them to place as much reliance as possible on the work of the other. This is especially significant in areas where both the PRA and the FCA will have a clear interest, such as governance and systems and controls more generally.

70. A particularly notable challenge will be to ensure sufficient co-ordination in the supervision of groups in which there are both PRA- and FCA- regulated entities. It is crucial to avoid conflicting or inconsistent regulatory judgements (or indeed duplication of work) being applied to different entities within a group.

Q18: 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?

71. In our view, actions by the FCA in respect of conduct issues would be likely to threaten the disorderly failure of PRA regulated firms, or financial instability, only in rare circumstances. We therefore recommend explicitly setting a high bar to use of the PRA's veto. The rather frequent references to the veto in the consultation paper could appear to suggest that the FCA was in some way subordinate to the PRA – which would not be consistent with the Government's position that 'the PRA and FCA will be equal in status' (para 5.6).

Q19: What are your views on the proposed models for the authorisation process – which do you prefer and why?

72. It would be less cumbersome and more efficient if one of the new regulators was responsible for mantaining the machinery to deal with authorisations, with the other providing input. As the FCA will regulate the largest number of authorised firms and individuals, it would make sense for the FCA to take on this role, but with a clear position that the PRA would need to consent to authorisation of any PRA-regulated activity being undertaken.

73. A similar approach might be most efficient for various other regulatory processes.

Q20: What are your views on the proposals on variation and removal of permissions?

74. We broadly agree with the proposal, though we would caution against the PRA using its veto in other than exceptional circumstances. Use of the veto would be tantamount to the PRA condoning the continuation of financial conduct which the FCA had judged to be unacceptable.

75. We note that withdrawal of one or more FCA permissions would not necessarily immediately compromise the financial viability of a firm. That would depend on factors such as the permissions in question, the capital of the firm and so on. Where a firm would remain viable in the short term, use of the PRA veto should be unnecessary.

Q21: What are your views on the Government's proposals for the approved persons regime under the new regulatory architecture?

76. It does not appear appropriate for the PRA to have sole right of final decision for positions in which there is an FCA as well as PRA interest (eg Chief Executive). It would be better for both authorities to have to consent where both have an interest.

Q22: What are your views on the Government's proposals on passporting?

77. We agree with the proposals, subject to suitable arrangements for the FCA to provide the PRA with relevant information on firms passporting into the UK from elsewhere in the EU.

Q23: What are your views on the Government's proposals on the treatment of mutual organisations in the new regulatory architecture?

78. We very much agree that the regulatory system should not favour or disadvantage particular ownership models. We also agree that, in principle, registration of mutual organisations not engaged in providing financial services does not naturally fit into the FCA's responsibilities. However, it will be important to pay close attention to the costs (both direct and compliance) of any proposal to move registration of mutuals away from the FSA / FCA.

Q24: What are your views on the process and powers proposed for making and waiving rules?

79. Given that PRA and FCA rules will have broadly the same status as secondary legislation, we are strongly of the view that the process disciplines applied to the making of FSA rules should continue, especially the requirement for public consultation on all rule changes.

80. We consider that, in the interests of transparency, the current FSA approach in which waivers are almost always published should be retained by both the PRA and the FCA.

Q25: 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.**

81. We endorse the view that effective regulation of individual entities requires close attention to the groups to which they belong (where relevant).

82. In our view, the CP does not make clear how the PRA veto power could apply to FCA-directions needed to meet EU requirements relating to consolidated supervision (para 5.70) – would use of such a veto be compatible with the UK's obligations under EU law?

83. We do not object to a power of direction over unregulated parent entities in specific circumstances, provided there are safeguards along the lines set out in the CP.

Q26: What are your views on proposals for the new authorities' powers and coordination requirements attached to change of control applications and Part VII transfers?

84. We agree with the approach set out in the CP.

Q27: What are your views on the Government's proposals for the new regulatory authorities' powers and roles in insolvency proceedings?

85. We agree with the approach set out in the CP.

Q28: What are your views on the Government's proposals for the new authorities' powers in respect of fees and levies?

86. We believe that the proposals in the CP need to be developed in greater detail. In our view, both the PRA and FCA should be required to publish annual documents which set out their business plan, proposed budget and calculation of fees applicable to different classes of firm. (as well as an annual report and audited annual accounts). In the case of the PRA, from a transparency and accountability perspective it is important that detailed financial information relating to its operations is publicly available. This should not be obscured by information being confined just to what will be available in the Bank of England's consolidated (group) accounts (which may present only summary information on the PRA, as just one part of the group).

Q29: What are your views on the proposed operating model, coordination arrangements and governance for the FSCS?

87. It may prove challenging to operate a structure in which two bodies, the PRA and the FCA, will make rules in relation to the FSCS, especially as some rules are likely to apply to both PRA- and FCA-regulated activities. There could be policy disagreements, for example regarding where the balance is struck between protecting consumers and minimising moral hazard. One way of mitigating this risk would be to ensure that the FSCS itself has a strong board.

Q30: What are your views on the proposals relating to the FOS, particularly in relation to transparency?

88. We are aware of concerns within the financial services industry that in practice FOS decisions can have policy making implications – but without the accountability of rule making by the FSA. Publication of FOS decisions would presumably accentuate these concerns. This suggests that the policy significance of FOS actions should be clarified as part of any move to publication.

Q31: What are your views on the proposed arrangements for strengthened accountability for the FSCS, FOS and CFEB?

89. We have no comments on this question.

Q32: What are your views on the proposed arrangements for international coordination outlined above?

90. We believe that in further development of the new approach to UK financial regulation more explicit attention should be given to the extent to which UK financial regulation is becoming embedded within a broader international and particularly European system, in the light of developments such as the strengthening of the G20 process and establishment of the European authorities for banking, insurance and securities markets.

91. Our understanding is that development of micro-prudential policy will increasingly be moving to the European authorities responsible for banking and insurance / occupational pensions, and that these bodies will pursue a common 'EU rule book'. On the face of it, this seems likely to constrain the scope in future for some types of unilateral action on micro-prudential regulation by the UK.

92. However, we note that greater freedom of action is likely to exist with respect to macro-prudential policy given that the UK is outside the euro area. Here, as noted above, the main issue is likely to be the extent to which other countries adopt a macro-prudential approach similar to the UK, and the challenges of applying something significantly different just in the UK if they do not do so.

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