

**Treasury Select Committee inquiry into the Financial Conduct Authority
Memorandum by the Investment Management Association**

Executive Summary

1. The IMA represents the asset management industry operating in the UK, which at the end of 2010, was responsible for the management from the UK of about £3.9 trillion of assets invested globally on behalf of clients drawn from around the world.
2. IMA members will be a significant constituency for the FCA. We do not expect them to be prudentially supervised by the PRA and they will accordingly be amongst the largest and most global businesses solely subject to FCA supervision. The vast majority of all rules applicable to them, whether in conduct of business or prudential matters, derive from European Directives and Regulations such as MiFID, UCITS and the Capital Requirements Directive.
3. The objectives of the Financial Conduct Authority (FCA) do not go far enough in relation to competitiveness which is an important issue to which the regulators ought to have regard.
4. The FCA will need to have a deep understanding of, and good intelligence about, the markets it regulates.
5. Formal accountability to Government has limitations which we recommend is supplemented by other mechanisms such as: more visibility for non-executive directors; fuller disclosure of the FCA's reasoning with regard to rule changes; and a single independent complaints commissioner for all FCA and Prudential Regulatory Authority (PRA) complaints.
6. While action in relation to product intervention is important to avoid consumer detriment there must be legal certainty to ensure product innovation is not disincentivised in the UK. That said, the FCA should be more willing to make full use of all the powers available to it.
7. The FCA should commit to properly communicating what is and is not guidance.
8. In the exercise of the veto power by the PRA over the FCA, the Financial Policy Committee (FPC) should be consulted. Public interest publication of the veto decision and the reasons for it should be for HM Treasury and not the PRA to decide.

Are the objectives of the Financial Conduct Authority (FCA) clear and appropriate?

9. The objectives as drafted are clear but do not go far enough on competitiveness.
10. The current formulation in the Financial Services and Markets Act 1999 (FSMA) requires the FSA to have regard to "the international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom". Presently these words do not appear in the FCA's objectives. We disagree with the removal of a reference to competitiveness as a particular issue to which the regulators must have regard. We believe the removal of this obligation will be contrary to the UK's national interest. Supporters of the removal suggest that retention of the existing duty would result in a "race to the bottom" with damaging impacts on financial stability or consumer protection. But if the UK regulators fail to consider what the rest of Europe is doing, for example on a Single Market directive, more and more product launches will occur in Luxembourg or Dublin and passport back in to the UK.
11. Despite the Government's position on competitiveness, the Bill retains wording designed to protect the UK's position as a location of choice for firms wishing to list their shares. This was introduced by the Investment Exchanges and Clearing Houses Act 2006, in response to fears that a takeover of the London Stock Exchange could have resulted in the effective importation of the Sarbanes-Oxley Act and other US legislation. When considering whether any regulatory provision proposed by an exchange is excessive, the FCA will still need to have regard to all factors including "the global character of financial services and markets and the international mobility of activity, [and] the desirability of facilitating innovation." We think these are criteria which can be applied more generally: we do not see why the listing rules should be singled out for such protection, but not other powers and duties of the FCA.

Should the FCA have a primary duty to promote competition as recommended by the Treasury Select Committee and Independent Commission on Banking? How should this work in practice?

12. We have no strong views on the benefit of this over the Government proposals on referrals and super-complaints where there has been mass detriment. The nominated parties should command respect as independent and unconflicted bodies.

Does the FCA's approach to regulation, as outlined in the Financial Services Authority (FSA)'s June 2011 document, represent an improvement on that of the FSA?

13. We think it is too early to say. Certainly it will depend upon the strategies and approaches set by the senior management team of FCA. We have stressed the need for FCA to have a deeper understanding of the market and better intelligence. FCA will also need to address internal disagreements, as it is

suggested there may have been over the timing and need to intervene concerning PPI mis-selling claims.

14. The FCA paper on supervisory approach does not address the use of external audit or review reports (under s.166 of the Financial Services and Markets Act (FSMA)) and we would be concerned were FCA to appear to have capped its costs by using more external investigators whose costs have to be met by firms direct.

To whom should the FCA be accountable? Are the lines of accountability clear?

15. Formally FCA must be accountable to Government, and through it to Parliament. We support the proposal to have four statutory Panels. We welcome the proposed role of the National Audit Office. There are limitations to such formal accountability; other mechanisms need to be in place to buttress it.

Non-executives

16. One possibility would be a more visible role for the non-executive directors. At present it is unclear to the industry what use is made of the skills and experience of the non-executives. By analogy with the role of non-executives on plc boards, they should be bringing an independent view to complement that of the executive team. And, just as non-executives in the corporate context can at times be a valuable conduit for external shareholders, so the non-executive directors of the FCA should be open to bring an external perspective to the FCA's deliberations. This is not to say that they should be seen as representative of industry, consumer or other stakeholder interests, nor that they should be seen as a legitimate target of lobbying by such interests. But they should be seen as providing a counterweight to executive management. As an example of what this might mean, individual non-executive directors could be charged from time to time with leading reviews of how policy has been undertaken or of specific regulatory episodes.

Publishing dissenting views

17. We would like to see a requirement for fuller disclosure of the FCA Board's reasoning for supporting or opposing specific rule changes. Dissenting comments should be recorded. Commonly we find the publication by the SEC of supporting and dissenting positions on regulatory issues very helpful. Similar practice by the Monetary Policy Committee has also been beneficial.

A single complaints commissioner

18. There should be a single independently-appointed complaints commissioner able to determine all FCA and PRA complaints (not one for each as proposed); this would prevent co-ordination complaints potentially falling between two commissioners. Whilst the current complaints commissioner role is relatively restricted (compared with the range of issues about which complaints as to FSA's actions might arise), the enhanced need for FCA and PRA (at least) to co-operate and co-ordinate may point to an increased role.

Are the powers of the FCA suitable? Will their exercise be subject to appropriate scrutiny? How should the FCA be interacting with industry as well as using its intervention powers?

Existing powers

19. FSA (*sic*) has a very wide range of powers. It is arguable that most of the steps the FCA might want to take on product intervention were already available to FSA under the own initiative variation of permission (OIVOP) power. The Financial Services Act 2010 widened them significantly. Overall there is a need to ensure the FCA does indeed use all the tools available to it. Despite all the existing powers of the FSA:

- There have been over one million cases at FOS since its establishment in 2000.
- Over £420 million has had to be raised by the FSCS for intermediary defaults in the last two financial years.

20. So we do not therefore oppose the policy behind the proposed new approaches to using existing (and additional) powers.

Product intervention

21. However the new Section 137C on product intervention is almost unlimited in its width. While we understand there is a need to consider product intervention on a much more proactive basis; the proposed clauses give unprecedented power to the FCA. The wording extends to almost any type of agreement. We think there is still a need for greater thought about how it might operate especially in relation to authorised persons providing cross border services and with contracts formed under the laws of other countries. Alongside a legitimate concern to ensure that consumers do not suffer detriment, there is a need to provide some level of legal certainty so as not to disincentive any form of product innovation in the UK.

The need for internal processes to ensure fairness

22. A more active (“intrusive”) use of powers places an even greater burden on the FCA to ensure that its internal processes are of the highest standards. In this regard we remind the Committee of the strong criticisms made by the Financial Services and Markets Tribunal (as it was) in the Legal & General case and which led to the enforcement process review¹ by the FSA.

23. The speed at which the FCA may be expected to act in relation to some of these new powers demands that a much more explicit statement of internal processes and protections should be put in place (or preserved in the transition from the FSA). At present the Bill and the FCA approach document provide little material on which to assess the extent to which internal processes at the FCA will be fair and meet the expectations of administrative law. We note that the FSA was not required by FSMA to have this approach and moved to it only in the light of “well-founded criticisms” from the Legal & General case. For that reason, we would expect the legislation to expect proper separation of aspects of the investigation

¹ http://www.fsa.gov.uk/pubs/other/enf_process_review_report.pdf

and decision-making processes within the FCA. It is entirely possible for legislation to provide sufficient detailed protections.

Greater clarity on rules, guidance and mere speeches

24. We would welcome far greater clarity from the FCA on the use of its rule-making powers compared to the FSA. It is only in the last year that FSA has effectively acknowledged that it has been publishing for years a series of documents (such as thematic reviews with recommendations) which most viewed as guidance, but which had not been subjected to the protections provided in FSMA of consultation and CBA. We would welcome a much clearer commitment from the FCA as to how it will identify guidance and other recommendations. Too many individuals at FSA felt able to make speeches at conferences which were meant to provide messages for behavioural changes but which led to greater uncertainty of application. If FCA wants firms to follow its guidance it should issue the same clearly and following any required process.

Improved dialogue with industry

25. For a more interventionist approach to succeed, market practitioners will have to have confidence they can speak about concerns with the FCA. At present dialogue between the industry and the Bank of England is of a different depth and quality than with the FSA. In part this arises from the FSA being the regulator but it is also about an approach which needs to be much less insular in policy formation.

Concerns over veto powers

26. We raise points about the power of PRA to veto the use of FCA powers below.

How will the break-up of the FSA work in practice? Issues of coordination and information sharing between the FCA and the Prudential Regulation Authority (PRA).

The veto powers

27. We have concerns over the veto power given to PRA over FCA (section 3H) and the risks that some banks will be over-protected; if not only through its use, but through FCA's perception of when it might be vetoed.
28. Generally we think the FPC as well as FCA should be consulted before its use; so section 3J(1) needs amending.
29. As regards publication, including to Parliament, of the veto decision and reasons for it, this should be for HM Treasury not (as proposed) PRA to decide what is in the public interest.
30. The veto power should never be able to be exercised in relation to any power given to FCA to prosecute a PRA-authorized person or bring a market abuse action.

Recognising the role of the FCA with client assets

31. Proposals about recovery and resolution plans and other crisis management issues have not yet recognised the role of the FCA as the body principally responsible for client asset protection policy. PRA will need to liaise with it in this regard.

Revising the permission regime and register

32. The regulated activities order and the FSA register and permission regime need to be fundamentally reviewed. There is no need for such a parochial and arcane system of permissions in light of European directives governing most activities of many firms. We remain to be convinced that the current system does anything other than add to costs and uncertainty. We cannot believe that consumers are assisted by having to consider several pages of permissions for a simple firm.

How should the FCA be interacting with other domestic regulators? For example, the FCA's relationship with the Bank of England and Financial Ombudsman Service.

Market intelligence

33. The legitimate interest of the FCA to have better market intelligence must not lead to duplication by it (or the PRA) of work conducted at the Bank of England. We consider that the market intelligence unit of the Bank of England is likely to be the central place for a large part of the wholesale market intelligence that needs to be gathered, given the committees it serves, and we would expect the FCA to draw from it whilst maintaining its own expertise in consumer market issues.
34. There will also be a need for close co-operation with the Bank of England in relation to its existing markets work (such as the Stocklending and Repo Committee) and its market intelligence activity and with the Debt Management Office (DMO).

Learning from failures

35. FCA must be much more open to learn both from FOS but also from FSCS. A few years ago we asked if FSA ever formally reviewed any matters which might come to light from the handling of defaults by the FSCS. We were told not. Just as it was no surprise that an insolvency practitioner first suggested living wills for complex regulated firms, we would expect FSCS would have insights arising from its wide interaction with consumers and failed firms.

How should the FCA be interacting with international regulators? Do EU regulation initiatives restrict or enhance the work of the FCA? Will the FCA be able effectively to engage with the EU supervisory authorities?

36. EU regulation is a fact of life in the areas of business of IMA members. This means not only the source of rules but also (and increasingly) a restriction on any local variation or implementation. And over the next few years the European

Supervisory Authorities will increasingly corral local regulators, such as the FCA, into harmonised approaches. This is a commitment the UK Government has made and the FCA will need to fit with it.

37. The FSA does effectively engage with the EU and internationally, it cannot always be successful but that is not a reflection on engagement, and we fully expect the FCA to continue to engage.

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