# Policy briefing

CII

January 2013

# Towards Twin Peaks: The UK's Emerging Regulatory Landscape (January 2013 Update)


## Summary

A new regulatory regime is almost upon us. From April 2013 three new financial services regulatory bodies will be established. With the Financial Services Bill having received Royal Assent in December, and the FSA and Bank of England already operating to a shadow structure mirroring the new regime, the future regulatory landscape is now clear.

**Financial Conduct Authority (FCA):**

- Separate independent regulator responsible for conduct of business and market issues for all firms and prudential regulation of small firms, like insurance brokerages and financial advisory firms.
- Will be focused on taking action early, before consumer detriment occurs.
- Shift towards thematic reviews and market-wide analysis to identify potential problems in areas like financial incentives.
- Will review the full product lifecycle from design to distribution with the power to ban products where necessary.

**Prudential Regulation Authority (PRA):**

- Will sit within the Bank of England and is responsible for the stability and resolvability of systemically important financial institutions.
- Will not seek to prevent all firm failures but will seek to ensure that firms can fail without bringing down the entire financial system.
- Will place emphasis on "judgment based" approach to supervision focusing on: the external environment, business risk, management and governance, risk management and controls and capital and liquidity.

**Financial Policy Committee (FPC):**

- A committee within the Bank of England responsible for horizon scanning for emerging risks to the financial system as a whole and providing strategic direction for the entire regulatory regime.
- The FPC will have the power to use so-called "macro-prudential tools" to counteract systemic risk. The tools might include imposing leverage limits on banks or enforcing particular capital requirements for given asset classes.
- With the Bank of England set to be in charge of micro-prudential and macro-prudential regulation, on top of its existing responsibilities for monetary policy, it is fast becoming one of the world's most powerful central banks.

### Next Steps (expected)

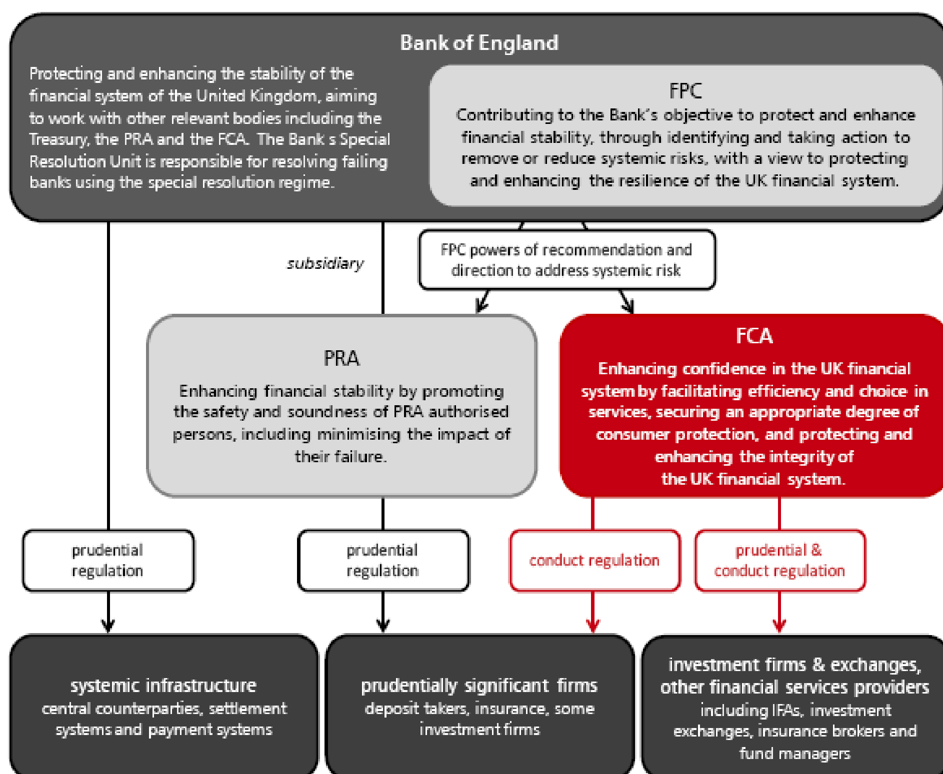
- Spring 2013: Secondary legislation related to the Financial Services Act 2012 to be passed.
- 1 April 2013: New regulatory structure comes into force.

# 1. Background

## Overview

Since 2010 the Government has been overhauling the UK's financial regulatory framework. Under current proposals, the Financial Services Authority is to be disbanded with responsibility for financial stability passing to the Bank of England. Within the Bank will sit the **Financial Policy Committee (FPC)**, responsible for horizon scanning for systemic risks and the **Prudential Regulation Authority (PRA)** responsible for the solvency and resolution of systemically important institutions. A new regulator, the **Financial Conduct Authority (FCA)**, will be responsible for ensuring consumer protection and markets regulation.

## Figure 1. High level Diagram of New Regulatory Structure (HM Treasury Interpretation)




## Latest developments

The recently passed Financial Services Act delivers the necessary legislative changes to enshrine the new regulatory architecture into law. Once the Secondary Legislation has also been passed, the new regulatory bodies will be fully operational. The **new structure will come into force on 1 April 2013.**

The Financial Services Bill received Royal Assent and became an Act in December 2012. Prior to this, the FSA recently published an 'Approach Document' setting out how the new conduct regulator (the FCA) will operate under the new regime. In addition, the Bank of England and the FSA have published two further approach documents – one on how the PRA will supervise insurers, the other on how the PRA will supervise banks. From these, we now have a good idea about what the new framework will look like, as well as how the regulators will go about their daily business.

## 2. Financial Conduct Authority (FCA)

### Chief Executive: Martin Wheatley

### Scope

It is proposed that the FCA will regulate approximately **27,500 firms**. This includes:

- **24,496** firms solely regulated (for prudential **and** conduct issues) by the FCA. These are firms that are deemed of limited systemic importance. Examples include: personal investment firms, investment management firms, mortgage or insurance intermediaries, authorised professional firms, providers of market trading infrastructure, and non-bank mortgage lenders. It will also include Lloyd's members' agents and Lloyd's brokers.
- **2,143** firms purely for conduct of business issues. These firms, deemed to be systemically important are prudentially regulated by the PRA and conduct regulated by the FCA. They include banks, building societies, credit unions and general insurers and life insurers, Lloyd's and Lloyd's Agents.
- **959** firms regulated under other legislation. These are electronic money institutions and payment institutions.
- **For a full breakdown of firm types and their respective regulators please see Appendix A.**

The FCA will also take over the FSA's existing responsibility for the Financial Ombudsman Service, will oversee the Money Advice Service, and have responsibility for the Financial Services Compensation Scheme.

### Objectives

- The Financial Services Act states that the FCA will have an overarching strategic objective to "ensure that the relevant markets function well".
- It will also have three operational objectives:

**Consumer protection: securing an appropriate degree of protection for consumers.**

**Integrity: protecting and enhancing the integrity of the UK financial system.**

**Competition: promoting effective competition in the interests of consumers in the markets for:**

  - Regulated financial services.
  - Services provided by a recognized investment exchange.

- Additional factors that the FCA (and PRA) must have regard to include:

**Efficient and economic use of resources.**

**Proportionality.**

  - Consumer responsibilities.
  - Transparency.

### Approach to regulation

- **Product intervention and governance**: the FCA will be more proactive and "intervene earlier in the product's life span and seek to address root causes of problems for consumers." This is already being taken forward in the

FSA's review of the retail development of structured products. Powers could include temporary intervention rules, product pre-approval. This is discussed in more detail below.

- **Super-complaints:** the FCA will become a body able to review and react to detailed submissions by consumer groups. Currently only the Office of Fair Trading can receive these "super-complaints" highlighting systematic problems in particular markets. Previous submissions have led to inquiries from the Competition Commission into payment protection insurance and extended warranties.

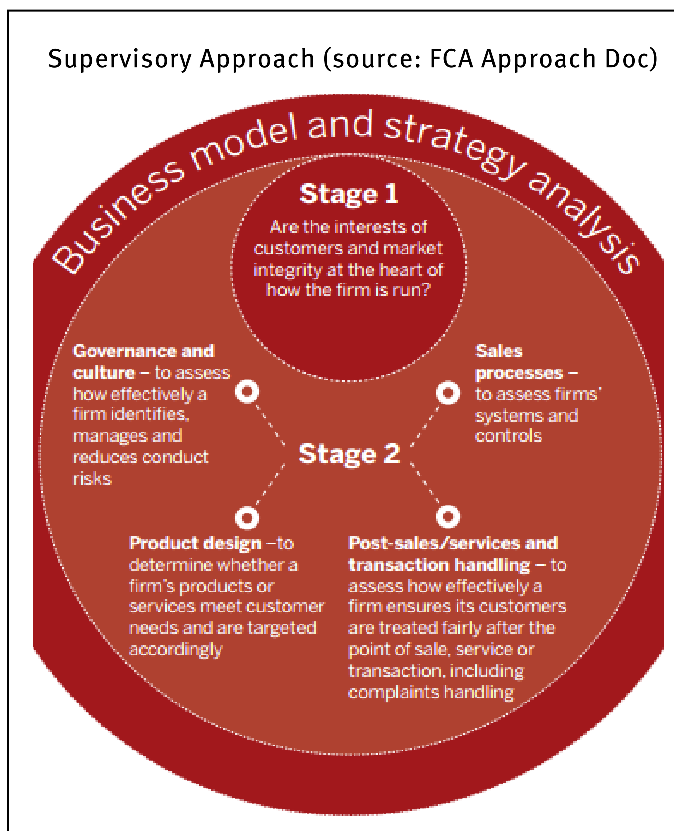
- **Competition powers**: the FCA has a new competition objective: "to promote effective competition in the interests of consumers". This will mean:

    - Firms must compete for business by offering better services, better value and types of products that customers want and need.

    - Prices offered are in line with costs.

    - Firms will innovate and develop new products over time: the FCA will draw a distinction between "good" innovation that meets consumers' genuine needs and other types that exploit consumers.

Supervisory Approach (source: FCA Approach Doc)




## Approach to supervision

- **General principles:** the supervisory system will be designed so that firms are encouraged "to base their business model, culture and how they run the business on a foundation of fair treatment of customers set out in the TCF initiative." The system "will act more quickly and decisively and be more pre-emptive in identifying and addressing issues before they cause harm, with senior staff involved in decisions at an early stage."

- **Supervisor organisation:** this approach will require a more flexible focus on bigger issues as they emerge, either in individual firms or across sectors. This will mean that some larger-risk firms might have an assigned supervisor with highly intensive contact, whereas others might be contacted once every 3-4 years.

- **Firm categorisation:** a new system is being introduced and firms will be contacted in early 2013 about which category they fall into. The system covers risk categories C1 (large banking and insurance groups with very large number of retail customers) to C4 (smaller firms including most intermediaries).

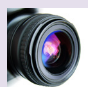
## Risk framework

A new risk framework is being developed that will replace the existing ARROW system. This will be based on the following three pillars:

1. **Firm Supervision Framework (FSF):** designed to assess a firm's conduct risk, asking the question "are the interests of customers and market integrity at the heart of how the firm is run?" This entails business model and strategy analysis, embedding of TCF including governance and culture, product design, sales and transaction process, and post-sales services.

2. **Event-driven work:** supervisory activity in response to issues that are emerging or have recently happened. This is the flexible element of how the FCA will allocate its supervisory staff so that resources are devoted to situations and firms of heightened risk to consumers. For example, whistle blowing alleged misconduct or a spike in reported complaints.

3. **Issues and products:** the flexible approach will also allow the FCA to look at reviews of issues and products as they take place.



## In focus: the FCA's approach to supervising small firms

The FCA will place firms into four different categories according to size and type of customer base (i.e retail/wholesale) ranging from those firms with a large number of retail customers (C1 firms) to "smaller firms including almost all intermediaries" (C4).

C4 firms will experience the least intrusive regulation of all. But supervisors will still be looking for small firms to identify and take action to reduce risks to consumers. The FSA has set in train the new supervisory model for small firms, known as the Revised Approach to Small Firms Supervision. This new framework consists of:

- A 'touch point' (e.g. roadshow, phone call or online assessment) with all C4 firms once every four years. Exact interaction will depend on FCA assessment of risks posed by firms.
- To identify initial level of risk the FCA will use the online reports that firms submit through GABRIEL, along with other data sources such as information from firm visits or the FCA's contact centre.
- Firms identified as high risk and 25% of medium risk firms will have face to face interviews. The FCA will provide verbal feedback at this stage, followed by a letter setting out any remediation points, which will need to be addressed by the firm's senior management.
- Firms deemed to be 'high risk' after the interview will be subject to a follow-up visit.

**Whilst the supervision of small firms will be relatively light-touch by comparison to larger firms, the degree of intrusiveness from the regulator will depend on the ability of small firms to evidence best practice in the interests of customers. Similar to large firms then, small firms must consider the appropriateness of employees training and competence, the governance of incentive schemes, and the kinds of systems and controls necessary to resolve potential conflicts of interest if they want to successfully navigate the new regulatory regime.**

## Earlier Intervention

As noted above, the FCA will have new powers to intervene to prevent detriment occurring. The Financial Services Act confirms a number of regulatory initiatives to shift the balance from tackling the symptoms of consumer detriment to the 'root causes'. Examples include:

### Banning Products (applies to the retail sector)

- Where the FCA identifies a serious problem with a product or product feature, it will be able to take timely and necessary steps to ban it.
- The legislation enables the FCA to make temporary product intervention rules without prior cost-benefit analysis or consultation valid for up to 12 months.
- The FSA has released a draft statement on its use of temporary product intervention here: http://www.fsa.gov.uk/static/pubs/other/draft-statement-policy-temporary-pi-rules.pdf
- The FCA will be required to consult on a set of principles governing the circumstances under which it will use this power.
- The FCA will only be allowed to use its product intervention powers in relation to retail customers.

### Withdrawing Misleading Financial Promotions

- The FCA will be able to take action in relation to misleading financial promotions.
- The FCA will also be able to disclose the fact that enforcement action against a firm or individual has commenced.
- The FCA will be required to alert a firm to its proposed course of action, and to allow for and consider representations by firms before publishing any details of its action.

## Publication of Enforcement Action:

- The FSA are already being more proactive about enforcement, and the last year or so has seen a marked increase in the intensity and incidence of enforcement actions.
- The FCA will drive this forward with even greater intensity, bringing more enforcement cases and pressing for tougher penalties, and being more willing to pursue cases against individuals including senior management.
- The FCA will be allowed to publish the fact that a warning notice has been issued about a firm as well a summary of the notice. This new power will be available to both the FCA and PRA.
- In making a decision about whether or not to disclose the warning notice, the regulator must consider a number of factors including whether publication of the information would be unfair to the person whom the warning notice relates.
- Indeed, the Government has noted that it intends to "make provision for the Government to retain the power to repeal the early warning notices power if at some point in the future, the power or use of it is contrary to the public interest"[1].

## Market intelligence gathering and research:

- The FCA will contain a new **Policy**, **Risk and Research Division** that will "combine research into what is happening in the market and to consumers with better analysis of the type of risks where they appear." It will be the "radar" of the organisation.

[1] Lord Sassoon speaking during a debate in the House of Lords (Oct 2012)

## In focus: the FCA's thematic and proactive approach

The FSA has said that this year's investigation and subsequent guidance consultation on **financial incentives** is an example of the type of work that the FCA will be undertaking going forwards. Following a thematic review of sales practices across retail financial services firms including banks, financial advisory firms and insurers, the regulator found that 20 out of 22 firms assessed did not properly identify how their incentive schemes might encourage staff to mis-sell. Indeed the FSA found that many firms did not understand their own incentive schemes because they were so complex, making the schemes hard to control.

As a result of the findings, the consultation noted that the FSA will consider strengthening the rules in the area of financial incentives. In the meantime, in order to help ensure better practice, the consultation set out the types of incentive schemes that might increase the risk of mis-selling and provided information on best practice in terms of the governance of incentive schemes.

**The financial incentives work is a clear indication of the likely direction of travel for the FCA – with a more "proactive", interventionist remit which uses thematic reviews to focus on the culture of firms from product governance to front line sales. Through future supervisory visits and thematic reviews, the regulator will be looking for evidence that firms put the interests of consumers at the heart of what they do. We can expect to see more action by the regulator in this vein once the FCA is up and running.**

For more information about the regulator's approach to financial incentives read our briefing on it here: http://www.cii.co.uk/media/3870676/cii_briefing_fsa_gc_financial_incentives_sep2012.pdf

- It will identify and assess risks to consumers, create a common view to inform the FCA's supervision, enforcement and authorisation functions.
- While relying on existing sources for evidence including consumer groups, the media and ongoing market monitoring and analysis, they will also make more use of consumer action line: whistle@fsa.gov.uk.

### Authorisation and Approvals

The fundamentals of the FSA's authorisation function are likely to remain the same. The FCA will focus on the proposed business model, governance and culture, as well as the systems and controls the firm intends to put in place especially over:

- Product governance.
- End-to-end sales processes.
- Prevention of financial crime.

The FCA will also work closely with the PRA in considering applications to approve individuals to roles which have a material impact on the conduct of a firm's regulated activities. The FCA will seek to assess that applicants have a good understanding of how to ensure good outcomes through:

- Corporate culture.
- Conduct risk management.
- Product design.

### Accountability

- The FCA will be required to report annually to Government and Parliament.
- There will be oversight of the FCA's work by a Board appointed by Government with a majority of non-executive directors.

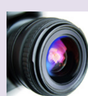
- The Act contains a provision for independent reviews on the efficiency and effectiveness of the FCA's use of resources.
- A requirement for the FCA to make a report to the Treasury in the event of a regulatory failure and where this failure was due to the FCA's actions.
- However, it is noted that the obligation to publish a report, and the desirability of transparency, should not impede or prejudice the FCA's ability to pursue enforcement investigations. **In such circumstances, publication would be delayed until enforcement action is completed.**

## Engagement with consumers

- The FCA will seek to build a better understanding of consumer behaviour, consumer needs and consumer experiences to shape how it designs its interventions.
- The FCA will also engage more with consumers directly, including through social media, consumer bodies, road shows, focus groups and face-to-face contact.
- And finally, the FCA will collect and analyse consumer information from other sources such as complaints, including those investigated by the ombudsman, and external commercial, academic and public interest research.

## Transparency and disclosure

- The FCA will be required to put in place four statutory panels representing the views of **consumers**, **regulated firms**, **smaller regulated firms and market practitioners.**
- The FCA will build on the FSA's approach to consultation as part of the rule-making process and will seek to develop more effective ways of getting feedback on proposals, including from consumers and their representatives.
- The FCA will publish more information about its views on markets (key trends, products and services) and the comparative performance of a firm.
- The FCA will recognise that necessary restrictions on disclosure exist in UK and EU law.
- However, where disclosure of information would be incompatible with the FCA's objectives, **the FCA will not have to disclose information.**



## In focus: complaints against the FCA, PRA and Bank of England

The new complaints regime for the FCA, PRA and Bank of England will be similar to the current regime which the FSA argues has been an *"effective and efficient way of dealing with complaints"* against the regulator. Indeed the FSA point out that given "*how closely the requirements set out* [in the Financial Services Bill]*....mirror those* [already] *in the Financial Services and Markets Act, we propose adopting a very similar approach".* Key requirements include:

- Regulators must deal with complaints within four weeks and where that is not possible, will arrange a timetable with the complainant.
- The FCA will process complaints submitted centrally even if the complaints are about one of the other regulatory bodies.
- The FCA will be responsible for recruitment of a new Complaints Commissioner, who will come in around April 2014. However, any final decision on the appointment will require agreement by all the three bodies.

The FCA complaints consultation paper can be found here: http://www.fsa.gov.uk/static/pubs/cp/cp12-30.pdf

# 3. Prudential Regulation Authority

### Head: Andrew Bailey

### Scope

According to the draft legislation, the PRA will be responsible for the prudential regulation of all "systemically important firms" defined as those firms that pose a risk to the financial system if they were to fail. The PRA will be responsible for the regulation of all institutions that accept deposits or which accept insurance contracts. This will mean that the PRA will authorise and supervise all banks, building societies, credit unions, general insurers and life insurers.

### Objectives

- Under the Financial Services Act, the PRA will have a primary objective to "promote the safety and soundness of PRA regulated persons".
- It will also have two secondary objectives:
    - Ensuring that PRA authorised persons carry on in a way which avoids adverse effect on the stability of the UK financial system.
    - Minimising the adverse effect that the failure of a PRA-authorised person could be expected to have on the stability of the UK financial system.

The Government also announced after considerable concerns raised by the CII and others that *"the distinct nature of insurance business ought to be recognised in the regulatory framework, including the PRA's objective."* A new section was added to the legislation to clarify the specific responsibilities that the PRA will face in relation to insurers. The insurance objective is:

> *"Contributing to the securing of an appropriate degree of protection for those who are or may become policyholders."*

In relation to this additional objective, the PRA also has a specific responsibility to secure:

> *"an appropriate degree of protection for the reasonable expectations of policyholders as to the distribution of surplus under* ***with-profits policies*** *"*

- It is worth noting that regulation of with-profits will also be a concern of the FCA. In anticipation of coordination problems with respect to the regulation of this type of financial services business, the regulators will have to adhere to a specific Memorandum of Understanding regarding with-profits regulation. The MOU can be found here:
- http://www.fsa.gov.uk/about/what/reg_reform/with-profits

### Threshold Conditions

- The 'Threshold Conditions' will be the minimum requirements that firms must meet in order to be permitted to carry on regulated activities. The Threshold Conditions for which the PRA will be responsible are designed to promote safety and soundness. At a high level, the draft Threshold Conditions require:
- A firm's head office, and in particular its mind and management, to be in the United Kingdom.
- A firm's business to be conducted in a prudent manner — and that the firm maintains appropriate financial and non-financial resources.
- The firm itself to be fit and proper and be appropriately staffed.

- The firm and its group to be capable of being effectively supervised.
- Firms must ensure that they meet the Threshold Conditions at all times. The PRA will assess firms against them on a continuous basis.

## Judgment-led regulation

The PRA's proposed judgment-led approach to supervision will be characterised by a move away from rules and a focus on forward looking analysis including an assessment of how a firm would be resolved if it were to fail, the impact this would have on the system as a whole and the use of public funds. The aim is therefore to "pre-empt risks before they crystalise". Central to the new approach is a new risk assessment framework.

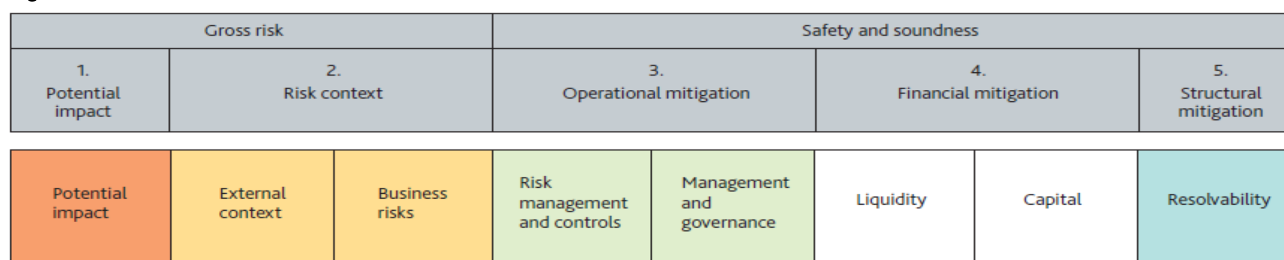
### Risk assessment framework

The Bank of England and FSA state that the new framework will operate in a way that reflects the PRA's additional objective to protect policyholders as well as the financial system. The framework will capture three elements:

1. **The potential impact** on policyholders and the financial system of a firm coming under stress of failing.
2. How the **macroeconomic and business risk** context in which a firm operates might affect the viability of its business model.
3. **Mitigating factors**, including risk management, governance, financial position including its solvency position and resolvability.

On announcing this new framework, former FSA Chief Executive Hector Sants said that supervisors must be wary of the limitations of measures (i.e. fixed capital requirements) deployed which are intended to reduce the risks posed by firms. Ultimately what is appropriate under certain stressed conditions may not be appropriate under others. The PRA must therefore have good oversight of firms, and supervision must involve senior and experienced individuals.

**Figure 2. The PRA's new risk framework**




### The intensity of supervision

The intensity with which firms will be supervised will depend on their level of riskiness related to the areas above. However, all firms will face at least a '**baseline level of monitoring**'. This will involve:

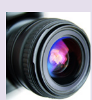
- Ensuring compliance with prudential standards for capital.
- Liquidity, asset valuation, provisioning and reserving.
- At least an annual review of the risks posed by firms or sectors to the PRA's objectives.
- Assessing a firm's planned recovery actions and how it might exit the market.

### Proactive Intervention Framework (PIF)

The PRA's judgement about proximity to failure will be captured in a firm's position within the Proactive Intervention Framework (PIF). Judgements about a firm's proximity to failure will be derived from those elements of the supervisory assessment framework (see diagram above) that reflect the risks faced by a firm and its ability to manage them —

namely, external context, business risk, management and governance, risk management and controls, capital and liquidity.

There will be five clearly demarcated PIF stages, each denoting a different proximity to failure, and every firm will sit in a particular stage at each point in time. As a firm moves to a higher PIF stage — i.e. as the PRA determines that the firm's viability has deteriorated — supervisors will review their supervisory actions accordingly. Senior management of firms will be expected to ensure they take appropriate remedial action to reduce the likelihood of failure. And the authorities will ensure appropriate preparedness for resolution.



## In focus: firms' culture and prudential supervision

As reported in 2011, the PRA will expect insurers to have a culture that supports their prudent management. Good prudential management must be pursued by all individuals working in an insurance company not just senior staff. But the PRA will have "no right culture in mind" when making judgements about firms.

The PRA will focus instead on "whether boards and management clearly understand the circumstances in which the insurer's solvency and viability come into question, whether accepted orthodoxies are challenged, and whether action is taken to address risks on a timely basis".

The Bank of England and FSA also state that under the PRA, firms must have:

- Sufficient controls to minimise excessive risk taking.
- Insurers and individuals must behave in an open and cooperative manner.
- An insurer's board must take responsibility for establishing, embedding and maintaining the type of culture described above.

**The PRA's supervisory approach suggests that firms will face increased scrutiny the more their organisational culture fails to demonstrate a strong, joined up model to managing the prudential risks related to their business. Supervisors will assess risks using expertise and judgement rather than box-ticking. It is therefore up to firms to show how their organisation is managing prudential risks appropriately – no one approach to risk management will be right for everyone. If firms fail to do this they could find themselves facing greater intervention from the regulator as they move up the PIF.**

## The regulation of Lloyd's of London

The PRA will be the lead regulator for Lloyd's as a whole though the FCA will take responsibility for certain conduct of business issues. The draft legislation confirms that *"The Society of Lloyd's and Lloyd's managing agents will be dual regulated firms; Lloyds members' agents and Lloyd's brokers will be FCA-regulated firms".*

## Industry engagement

It has been stated that the PRA will engage with the boards and senior management of firms in forming its decisions, using this dialogue both to ensure that it takes account of all relevant information in reaching its judgments, and to communicate clearly the rationale for them. Firms should not, however, approach their relationship with the PRA as a negotiation.

### Two new handbooks

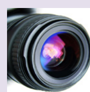
At legal cutover, the FSA Handbook will be split between the FCA and the PRA to form two new Handbooks, one for the PRA and one for the FCA. Most provisions in the FSA Handbook will be incorporated into the PRA's Handbook, the FCA's Handbook, or both, in line with each new regulator's set of responsibilities and objectives.

The new Handbooks will reflect the new regulatory regime (for example, references to the FSA will be replaced with the appropriate regulator), and in some areas more substantive changes will be made to reflect the existence of the two regulators, their roles and powers.

## Coordination

Given the potential for regulatory overlap between the FCA and PRA, the legislation provides a number of general coordination mechanisms:

- A **statutory duty on the PRA and the FCA to coordinate** their activities (including consulting with one another to gather views where necessary).
- An obligation to prepare a **Memorandum of Understanding** (including setting out the role of each regulator and how they are interlinked). The draft MoU between the FCA and the PRA can be found here: http://www.fsa.gov.uk/static/pubs/mou/fca_pra.pdf
- Cross-membership of boards.
- A **veto mechanism** for the PRA to reduce the risk of regulatory actions threatening financial stability or the disorderly failure of a firm. See below "in focus" box for more details.
- A requirement that the PRA and FCA include in their annual reports an account of **how they have coordinated during the year.**
- The regulators have also set out a **MoU on with-profits** business between the PRA and FCA as outlined above (see top of page 9).



### In focus: the PRA's veto power

The PRA's power of veto ensures that the new regulatory regime can at certain times of stress prioritise financial stability over consumer protection. According to the Financial Services Act, the PRA can direct the FCA to refrain from particular action if it believes that action might threaten financial stability or result in the failure of a PRA - authorised person.

**In "normal times", free of serious economic stress, there is arguably little risk of the veto being invoked. But it is far from certain how it will be used during episodes like the recent financial crisis. Questions remain about when the PRA will decide to invoke this power and what effect this will have on customers.**

# 1. Financial Policy Committee

### Chair: Bank of England Governor (Sir Mervyn King until May 2013; then Mark Carney)

### Scope and objectives

Run by the Bank of England, the FPC has responsibility for macro-prudential supervision. It is responsible for spotting the systemic risks "attributable to structural features of financial markets or to the distribution of risk within the financial sector". It is also responsible for identifying unsustainable levels of leverage, debt or credit growth.

Having identified the risks, the FPC will have the power to take various policy measures to counteract them. Examples of so-called **macro-prudential tools** include:

- **Setting countercyclical capital buffers**: Ensuring that banks increase their capital in the 'good times' so they have protection for the bad. This should also have the affect of tempering lending during a boom and so dampening the effect of the credit cycle.
- **Variable risk weights**: Enforcing targeted capital requirements on specific sectors or asset classes. This could include requiring banks to hold greater levels of capital against asset exposures that represent substantial risk.
- **Leverage Limits**: Limiting excessive build up of on and off balance sheet leverage. Since measures of risk can be unreliable, a leverage ratio could act as a back-stop to risk-weighted requirements (such as a capital buffer).

As well as these financial stability considerations, the FPC will also have a statutory obligation to limit the impact of its policies on economic growth.

To read more about the Bank of England's macro-prudential tools please see the following discussion paper: http://www.bankofengland.co.uk/publications/Documents/other/financialstability/discussionpaper111220.pdf

### Governance

The FPC will have a total membership of 12, comprising six executives of the Bank of England, and five members from outside the Bank. In addition, the FPC includes a non-voting Treasury member. It is chaired by the Governor, and includes the existing Deputy Governors for monetary policy and financial stability, and the newly created Deputy Governor for prudential regulation.

The Chief Executive of the FCA will also sits on the FPC, as will a further four independent external members, appointed by the Chancellor and recruited in a similar manner to the current external membership of the MPC.

### Members of the FPC

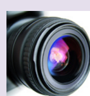
- The Governor of the Bank (acting as Chair of Committee).
- The Deputy Governors for financial stability and monetary policy.
- The newly created Deputy Governor for prudential regulation (who will also be the Chief Executive of the PRA).
- Two senior Bank executives, responsible for financial stability and for markets.
- The Chief Executive of the FCA.
- Four independent members appointed by the Chancellor.
- A non-voting Treasury representative.

The Government has noted the importance of external members having direct market expertise in areas such as insurance. *"The Government and the Bank of England are committed to ensuring an appropriate balance and breadth of expertise for both the interim FPC and the permanent body and will make all efforts to ensure this is the case".*

## Accountability

The Treasury will be able to provide the FPC with guidance in the form of a remit alongside its statutory objectives, to help shape its pursuit of financial stability. The FPC will be required to respond to the Treasury's recommendations, setting out to what extent it agrees with the remit and what action it intends to take in response. However, according to the legislation, the FPC may reject any recommendations from the Treasury which it does not agree with.

The Government has legislated to require the FPC to publish a Financial Stability Report twice a year. Once the FPC has completed and agreed its reports, it will send them to the Treasury, which will, in turn, lay copies before Parliament. The Government requires the FPC to publish a record of each FPC meeting within six weeks. These meeting records describe the FPC's discussions in broad terms, but without identifying the contributions of individual members.



### In focus: the world's most powerful central bank

With the Bank of England having independent responsibility for monetary policy, "macro-prudential regulation" and "micro-prudential regulation", many argue that the Governor of the Bank of England will be the world's most powerful central banker.

Not surprisingly, given this level of responsibility, Parliament and the Treasury Select Committee (TSC) in particular have raised their concerns about the level of power vested in a few hands. They have also raised concerns about the accountability of what some argue is a rather antiquated and centralised institution.

Even though current Bank of Canada Governor Mark Carney has been named as the new Governor of the Bank of England with effect from May 2013, the TSC still have the power to veto this appointment. The Committee is also undertaking an inquiry into the Bank's flagship policy of Quantitative Easing. But serious questions remain about the accountability and transparency of the Central Bank and their ability to take on such significant responsibilities. Expect more political wrangling on this theme in the year ahead even if in broad terms the Bank's future role is now set.

## 2. European Representation

The legislation touches on how the new regulatory structure will engage with Europe. With regards to representation within the various European bodies the following has been decided:

- The Bank of England will sit on the **European Systemic Risk Board**.
- The PRA, as a regulator of banks and insurers, will hold the UK seat on both the **European Banking Authority** and the **European Insurance and Occupational Pensions Authority**.
- The FCA will represent the UK at the European Securities and Markets Authority.
- The Treasury will continue to represent the UK in political-level negotiations on **European directives and regulations.**

In order to ensure a **consistent strategic view** across the different regulatory bodies there will be a memorandum of understanding covering:

- The process for discussing and agreeing strategic objectives.
- Which authority represents the UK in each European body.
- How the authorities will coordinate their engagement in international bodies.
- How each authority will consult the others in advance.
- How authorities will seek views from interested parties in advance of meetings.
- The memorandum of understanding on **international organisations** can be accessed from:
- http://www.hm-treasury.gov.uk/d/fin_fs_bill_mou_international_organisations_jan2012.pdf

## Next Steps

Whilst the Financial Services Act has received Royal Assent, the new regulators will only officially come into operation once the Secondary Legislation is also passed. The Government has said the new structure will come into force on 1 April 2013.

## Useful Links

The **Financial Services Act**: http://services.parliament.uk/bills/2012-13/financialservices.html

The **FCA's approach to regulation**: http://www.fsa.gov.uk/pubs/events/fca_approach.pdf

The **PRA's approach to insurance regulation**: http://www.fsa.gov.uk/static/pubs/other/pra-approach-insurance.pdf

The **PRA's approach to the regulation of deposit taking institutions**:

http://www.fsa.gov.uk/static/pubs/other/pra-approach-banking.pdf

The **Financial Policy Committee**: http://www.bankofengland.co.uk/financialstability/Pages/fpc/default.aspx

## CII Briefings

A specific briefing about the Financial Conduct Authority can be found here: http://www.cii.co.uk/knowledge/policy-and-public-affairs/articles/cii-briefing-the-journey-to-the-fca/22599

A specific briefing on the FSA guidance consultation on Financial Incentives can be found here: http://www.cii.co.uk/media/3870676/cii_briefing_fsa_gc_financial_incentives_sep2012.pdf

# Appendix A – Types of firms and their respective regulatory bodies

**FCA regulated firms – conduct and prudential**

| Legal entities | Total |
|---|---|
| Personal investment firms | 6,198 |
| Insurance intermediaries | 6,246 |
| Mortgage intermediaries | 1,640 |
| Investment managers | 2,124 |
| Non-deposit taking lenders | 137 |
| Corporate finance | 452 |
| Wholesale firms | 224 |
| Custodians | 149 |
| Professional firms | 333 |
| Markets (exchanges & infrastructure providers) | 27 |
| Collective investment schemes | 561 |
| Other (including travel insurance only and media firms) | 6,388 |
| Other brokers | 2 |
| Managing agents | 4 |
| Investment firms | 11[2] |
| **Conduct and Prudential Total** | **24,496[3]** |

## FCA regulated firms – conduct of business only

| Legal entities | Total |
|---|---|
| Banks | 319 |
| Building societies | 49 |
| Investment banks | 25 |
| Credit unions | 652[6] |
| Friendly societies | 133 |
| Life insurers | 193 |
| General insurers | 636 |
| Wholesale insurers, commercial insurers & reinsurers | 64 |
| Lloyd's & Lloyd's Agents | 72 |
| Conduct Only Total | 2,143[7] |

Source: FSA (June 2011) The Financial Conduct Authority: Approach to Regulation

**CII Policy and Public Affairs**
**Chartered Insurance Institute**

**January 2013**