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

8 September 2011

Dear Sirs

HM Treasury white paper: A new approach to financial regulation: the blueprint for reform

PricewaterhouseCoopers LLP ('PwC' or 'we') welcome the opportunity to comment on the white paper. Our general observations on the proposals where they are relevant to our business and experience are set out in this covering letter. Where we are responding to individual questions, this is set out in the appendix to this letter.

We responded to the previous consultation paper published in February. In this letter, as well as outlining our views on any new issues raised by the white paper and draft bill, we expand upon a few points that we made previously which we believe are particularly important.

Clear governance and accountability
In our view the overarching governance framework for the Bank of England, the Prudential Regulatory Authority (PRA) and the Financial Conduct Authority (FCA) are critical to the success of the new regulatory model. The governance and accountability arrangements for the PRA and the FCA should be consistent, and should take account of the recommendations to be made by the Treasury Committee's inquiry into the accountability of the Bank of England.

International competitiveness
We believe that both the PRA and FCA should be required to 'have regard' to the competitiveness of the UK compared to other international financial centres. While it is important that the new arrangements enhance financial stability, it is equally important that the financial services sector can help support economic growth.

Co-ordination between the UK regulators and internationally
We believe that the PRA and FCA's respective objectives should include effectively co-ordinating their activities with those of ESMA, EIOPA, the EBA and other international bodies. The FSA and other UK regulatory bodies have a strong record of constructive engagement and influence in European and international bodies and the responsibilities under the new regime should enable this to continue.

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We hope you find our response to the white paper useful. If you would like to discuss or clarify any matter in this response, please contact Pat Newberry (020 7212 4659), Anne Simpson (020 7804 8123) or Laura Cox (020 7212 1579).

Yours sincerely

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The Bank of England and Financial Policy Committee

1. *Do you have any specific views on the proposals for the FPC as described above and in Chapters 3 and 4?*

We believe that the role of the Financial Policy Committee (FPC) within the Bank of England's existing governance framework and its accountability for decisions should be made clearer. The Bank will have responsibility for both regulatory and monetary policy, which may conflict from time to time. The FPC will be a committee of the Court of the Bank of England, and will be required to take account of the Bank's overall financial stability strategy which will be set by the Court, whose members are Crown appointments. It is important that the FPC is publicly accountable for its decisions and, as noted in our response to the previous consultation, it would be prudent to set out a clear governance framework for the FPC, including a framework for managing conflicts between monetary and regulatory policy decisions.

The first report of the Interim FPC contained a number of recommendations which relate largely to financial reporting. We believe that while the FPC has a significant role to play in this area, any recommendations made by it should be required to take into account the existing framework for financial reporting, that is, UK GAAP, EU-adopted IFRS and UK Company Law.

3. *Do you have any comments on*

- *the proposed crisis management arrangements; and*
- *the proposals for minor and technical changes to the Special Resolution Regime as described above and in Chapters 3 and 4?*

The proposals for co-ordinating crisis management focus on co-ordination between HM Treasury, the Bank of England and the PRA. The draft Bill gives scope for the Memorandum of Understanding (MoU) to be extended to other parties, including the FCA. We believe that it is important for the FCA to be a party to the MoU.

If the FCA is not included in the MoU, there is a risk that in a crisis, the potential implications for consumers of any decision taken during the crisis might not be not fully and effectively evaluated, resulting in consumer detriment. One of the biggest challenges of managing a crisis of any financial institution is thoroughly considering the impact of any decision taken on its customers. None of the other authorities has protecting consumers as a specific remit, and therefore they are less likely to be in a position to fully analyse the impact on customers quickly in a crisis.

Also, the roles and responsibilities of the authorities, in the event of the failure of an FCA-regulated entity, are not clearly defined. We would expect that managing a crisis relating to any FCA-regulated entity would require the direct involvement of the FCA, to ensure that knowledge gained through supervision of that entity was readily accessible and taken into account. If a FCA-regulated group failed which had PRA-regulated subsidiaries, the FCA would need to be involved to ensure that the crisis management process was managed appropriately and effectively.

It would also be prudent to require the PRA to consider involving the FCA in crisis management where it deems it appropriate. We believe that it is not possible to predict in advance all types of

entities which might prove to be systemically important in the event of a crisis. Also, it is possible that the failure of certain investment firms which will be prudentially regulated by the FCA could precipitate a crisis.

The Prudential Regulation Authority (PRA)

4. *Do you have any comments on the objectives and scope of the PRA, as described above and in chapters 3 and 4?*

We welcome the inclusion of a specific PRA insurance objective, being: 'contributing to the securing of an appropriate degree of protection for those who are or may become policyholders'. However specific reference to policyholders makes the more general PRA objectives appear somewhat unbalanced, as the legislation does not specifically refer to other types of customers (e.g. depositors). We suggest that it would be appropriate to add similar objectives for the other types of businesses the PRA will regulate (i.e., deposit-takers and investment firms), for example regarding those who are or may become depositors.

We strongly believe that both of the new regulators should be required to 'have regard' to the competitiveness of the UK as a financial centre, so that the UK continues to remain an attractive and competitive place to do business as compared with other international financial markets. We believe that the new regulators need to allow a high level of choice in the UK financial services sector and to facilitate new entrants to the market, many of whom are likely to come from abroad. In particular, increased concentration in the banking industry following the financial crisis and the consolidation of banking groups is seen by many as having reduced competition to the detriment of consumers. We encourage HM Treasury to give the PRA, as well as the FCA, an objective to promote competition internationally and within the UK where this does not conflict with their other objectives.

As well as deposit-takers and insurers, the PRA will regulate systemically important investment firms, of which there are likely to be few. Using legislation to strictly define what is a "systemically important investment firm" may reduce flexibility and increase the risk that such firms are not appropriately identified. We recommend that it should be left to the PRA and FCA to consider each investment firm on a case by case basis where there is any possibility that the firm may be a candidate for PRA supervision. If a case arises where the PRA and FCA cannot agree then the FPC should act as arbiter.

Many groups will contain both deposit-takers or insurers and non-systemically important investment firms. To simplify regulatory oversight without increasing systemic risk, we recommend that HM Treasury allows deposit-takers or insurers to guarantee the liabilities of their non-systemically important regulated subsidiaries, thus taking all the group entities out of the scope of FCA prudential regulation. The liabilities of the non-systemically important group companies will be included in consolidated supervision and would also feature on a solo-consolidated basis in the guaranteeing entity.

5. *Do you have any comments on the detailed arrangements for the PRA described above and in Chapters 3 and 4?*

Although the white paper noted that the accountability mechanisms for the PRA broadly mirror the existing provisions for the FSA, because the PRA will be a subsidiary of the Bank of England there is a fundamental difference in the governance structures between the PRA and the FSA. Regulatory and monetary policy will be concentrated within the Bank of England's group. It would be prudent for HM Treasury to consider the processes for appointment and removal of members of the Court of the Bank of England, the Governor, and for ensuring that the Court and the Governor are appropriately accountable and that their decision-making process and outcomes are transparent and public, particularly in times of crisis. In developing the governance and accountability structures of the PRA, the Government should take account of the recommendations to be made by the Treasury Committee's inquiry into the accountability of the Bank of England.

The white paper demonstrates that the Government believes that the PRA should be free to decide what mechanisms it wants to use to engage with industry. However, we continue to believe that it would be appropriate for the PRA to retain the existing practitioner panels, particularly with respect to capital.

Financial Conduct Authority (FCA)

6. *Do you have any views on the FCA's objectives – including its competition remit – as set out above and in Chapters 3 and 4?*

The draft Bill rebadges the FSA as the FCA. We noted that in the draft Bill, the definition of 'the Authority' (i.e., the FSA in the extant FSMA) in section 417 has been deleted but some references to 'the Authority' remain in the text. Throughout the Bill, it is important that references to the FCA and PRA are precise. In particular, as an auditing firm we note that the requirement to report matters of material interest to the regulator is to 'the Authority' and therefore ask that the text relating to the auditors' right and duty to report is clarified.

7. *Do you have any views on the proactive regulatory approach of the FCA, detailed above and in chapters 3 and 4?*

The purpose of and justification for the FCA's new power to issue warning notices before enforcement action is taken against a firm or indeed before the existence and/or nature of breaches has been confirmed is unclear. It seems likely that in most cases, the FCA's other powers regarding product intervention as set out in section 137C of the draft Bill would be more appropriately used to prevent the most severe cases of consumer detriment.

If the FCA issues warning notices in circumstances where it has not fully investigated the facts, it may risk unfounded reputational damage to firms, which could have a long-term detrimental impact on the firm. In some cases, such action could even undermine rather than facilitate financial stability. We suggest that the FCA's powers to issue warning notices should be limited to cases where there is immediate potential detriment to consumers or counterparties, which cannot be mitigated through the use of the FCA's product intervention powers.

8. *What are your views on the proposal to allow nominated parties to refer to the FCA issues that may be causing mass detriment?*

9. *What are your views on the proposal to require the FCA to set out its decision on whether a particular issue or product may be causing mass detriment and preferred course of action, and in the case of referrals from nominated parties, to do so within a set period of time?*

15. *Do you have any comments on the proposals for the FSCS and FOS set out above and in Chapters 3 and 4?*

We broadly welcome the proposals and in particular the requirement for the FCA to publicly respond to issues which may cause mass detriment which are brought to its attention. However, we are also concerned that the current proposals could be seen as a downgrade of the role of Financial Ombudsman Service (FOS), if it had no role on mass issues other than referring them to the FCA and/or the ability of individual consumers to access FOS were eroded. The FCA's stance on particular issues should not in any way prevent individuals bringing appropriate cases to FOS based on specific facts and circumstances. Currently no procedure for review or appeal of FOS decisions exists. We believe that it would be appropriate for FOS decisions on individual cases and FCA decisions on mass issues to be able to be challenged, either through the Courts or another appropriate means of appeal.

We also recommend that HM Treasury clarifies which parties would be able to bring issues that may be causing mass detriment to the FCA's attention.

10. *Do you have any comments on the competition proposals for the FCA set out above and in chapters 3 and 4?*

We welcome the inclusion of a competition objective and mandate for the FCA. However, the FCA's competition mandate appears to focus on competition within the UK market and the benefits for consumers with regards to cost and product innovation. However we continue to strongly believe that the FCA (and the PRA, as stated in our response to question 4 above) should be required to have regard to the competitiveness of the UK market *vis-à-vis* overseas markets (excluding the EEA).

11. *Do you have any views on the proposals for markets regulation by the FCA, described above and in Chapters 3 and 4?*

The FSA and HM Treasury have made it clear that the FCA will be a more interventionist regulator than the FSA. Currently, the UKLA can only resort directly to enforcement action against issuers. We see introducing skilled persons appointment powers as a proportionate response to providing the FCA (in its capacity as UKLA) with the appropriate tools to conduct investigations. The s166 regime has proved to be a valuable tool in the financial services industry.

Whilst there will be a cost arising this will be borne by the entities subject to skilled person reports, rather than by the wider industry through levies on all issuers.

12. *Do you have any views on the governance, accountability and transparency arrangements proposed for the FCA, as described above and in Chapters 3 and 4?*

The governance and accountability structures for the FCA should be consistent with those of the PRA, and, as noted at 4 above, take account of the recommendations to be made by the Treasury Committee's inquiry into the accountability of the Bank of England.

The transparency arrangements for the FCA (and the PRA) should also allow that, in exceptional circumstances, decisions may quite properly need to be taken without full public disclosure, where such disclosure would conflict with the FCA or PRA's objectives.

13. *Do you have any comments on the general co-ordination arrangements for the PRA and FCA described above and in Chapters 3 and 4?*

In our response to the previous consultation, we recommended that the MoU between the FCA and PRA should take account of areas of regulation which are likely to fall within both regulators' remits, such as the existing SYSC, PRIN, APER and BIPRU books. We continue to believe that in areas where there is joint responsibility —and where the regulators will inherit identical existing rules — there should be joint rule-making. Firms will also need to consider the impact of European Regulations and European Binding Technical Standards. Under the current proposals, which leave the level of co-ordination to the regulator's discretion, dual-regulated firms and groups will need to ensure compliance with three potentially conflicting sets of rules. Since this is likely to be unduly burdensome we continue to believe that the PRA and FCA should be required to 'have regard' to consistency in their rules, set out in legislation or formally in the MoU.

In some cases, rule-making which focuses on the regulators' primary objectives could conflict, for example with regard to competition and financial stability, and in these instances the regulators will need to agree on rules which can meet both their objectives. Currently, for example, it is not clear on how consultation between PRA and FCA on with-profits business should work. With-profits business has both a consumer protection and prudential implication. We hope that more concrete proposals for dealing with this and similar issues are made public shortly.