

A black and white photograph showing a low-angle view of several tall skyscrapers reaching towards a cloudy sky. The perspective is from the ground looking up, creating a sense of height and scale.

The Road Ahead – preparing for changes to the UK regulatory regime

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Institutional reform: the big idea

- The “*underlap*” phenomenon:
 - The tripartite system failed in the crisis as there was too much disconnect between the macro economic role of the Bank of England (BoE) and the build-up of risk in institutions
 - So key problem is to have adequate information flow to ensure proper oversight of macro-prudential risk in the light of micro-prudential reality
- Solution is to give the BoE back the prudential supervision role taken away in 1998 (through a subsidiary), but this time not just for banks but for other systemically important institutions
- Separate concerns about the lack of consumer education and need for a robust framework for protection of consumers

What is the solution?

A new regulatory framework for the UK

- **Macro-prudential:** the new Financial Policy Committee (FPC) in the Bank of England
 - Responsibility for maintaining financial stability
- **Prudential:** the Prudential Regulation Authority (PRA), a new subsidiary of the Bank of England
 - All deposit-taking institutions, insurers and investment banks will fall under its remit
- **Consumer protection and markets:** a consumer protection and markets authority (CPMA)
 - To promote confidence in financial services and markets

FPC: what are its objectives?

- **Primary statutory objective:** “contributing to” financial stability by:
 - Identifying and addressing risks and vulnerabilities across the system
 - Addressing imbalances through the financial system, for example by damping the credit cycle
- **Secondary factors?** To be consulted on – may include factors such as:
 - Economic or fiscal impact of macro-prudential decisions
 - Statutory objectives of the PRA and CPMA

FPC: what will it do?

Main function will be to undertake macro-prudential regulation, encompassing three broad areas:

- **Monitoring the system:** to identify risks to financial stability
 - Will assess the activities of the PRA and CPMA
- **Taking action:** in response to the risks and vulnerabilities it identifies
 - Will decide whether to use macro-prudential tools
- **Reporting on action:** to Parliament and the wider public
 - Will publish regular reports and records of decisions

FPC: what tools will it have?

- Macro-prudential tools are already being considered at international and European levels
 - Government committed to international system
- Two categories of tools are available:
 - Tools that address fundamental vulnerabilities
 - Tools that increase resilience to cyclical developments
- The tools available to the FPC will be set out by the Treasury in secondary legislation
 - PRA will be required to implement FPC's decisions by applying them to relevant firms
 - CPMA will be required to do the same if relevant
 - Precise nature of tools unclear at this stage

FPC: who will the members be?

- Total membership of 11:
 - Six executives of the Bank of England
 - Governor
 - Three Deputy Governors for monetary policy, financial stability and prudential regulation
 - Two bank executives responsible for financial stability and markets
 - Five others, (including the chief executive of the CPMA)
 - Plus a non-voting Treasury representative
- Membership designed to allow for cooperation between the three regulatory bodies
- FPC will meet at least four times a year

PRA: what are its objectives?

- **Primary statutory objective:** promote the stable and prudent operation of the financial system
 - Through the effective regulation of financial firms
 - In a way that minimises disruption by firms that fail
- **Secondary factors:** subject to consultation, the PRA will have regard to the following factors:
 - Objectives of other regulatory authorities
 - Principles of good regulation (not necessarily all of those that apply to the FSA)
 - Wider factors, such as the economic impact of policies and effects on consumer and business lending

PRA: what is its scope?

- The PRA will be responsible for:
 - authorisation
 - regulation
 - day-to-day supervision of firms subject to “significant prudential regulation” in the following categories:
 - Banks and other deposit takers, including building societies and credit unions
 - Broker-dealers/investment banks
 - Insurers, including friendly societies

PRA: what is its scope? (Cont'd)

- Regulated activities covered by the PRA will include:
 - Taking deposits
 - Effecting and carrying out contracts of insurance
 - Dealing in investments as principal

PRA: what are its key functions?

- Judging the safety and soundness of financial firms and taking appropriate action
- Making the rules which govern performance of regulated activities
- Authorising firms to engage in regulated activities
- Supervising and, where necessary, enforcing compliance with the rules
- Approving individuals to perform controlled functions within financial firms
- Raising levies to fund the activities of the PRA

PRA: how will it work with the CPMA?

- Each authority will have regard to the objectives of the other
- Cross-membership of the boards
- Statutory memoranda of understanding setting out the mechanics of day-to-day cooperation
- Legal provision for information gateways between the authorities
- Consultation between the authorities
- Coordinated supervisory and enforcement action where both authorities have an interest

PRA: how will it differ from FSA?

- Government stresses that processes and legal framework of new PRA will:
 - Support and facilitate a new, more judgment-led style of prudential regulation
 - reduce and simplify rules and guidance in FSA Handbook
- But following remains unclear:
 - How will style of PRA's regulation differ from FSA's current regulatory philosophy of intensive supervision?
 - Which firms will be subject to "significant" prudential regulation?
 - How will AML regulation be affected by the PRA's reduction and simplification of rules/guidance?

CPMA: what are its objectives?

- **Primary statutory objective:** ensuring confidence in financial services and markets
 - Particular focus on protecting consumers and ensuring market integrity
- **Secondary factors:** subject to consultation, the CPMA will have regard to the following factors:
 - Objectives of other regulatory authorities
 - Principles of good regulation (not necessarily all of those that apply to the FSA)
 - Public interest matters, such as the impact of policies on lending, promoting public understanding of the financial system and the need to maintain diversity in the sector

CPMA: what is its scope?

The CPMA will regulate:

- Conduct of all firms, including those authorised and subject to supervision by the PRA, in their deals with retail customers
- Dealings in wholesale markets, including:
 - Conduct of all financial services firms in wholesale markets
 - Firms providing market services
 - Market conduct more generally
- All financial institutions that are not regulated prudentially by the PRA

CPMA: how will markets be regulated?

- The CPMA will be responsible for regulating:
 - Organised financial markets whose facilities are provided by investment exchanges and multilateral trading facilities
 - Over-the-counter financial markets in which off-exchange dealings take place bilaterally between financial institutions and other large wholesale market participants
 - In relation, in principle, to all financial instruments and other derivative contracts traded on those markets
- The Bank of England will take oversee settlement systems and central counterparty clearing houses

CPMA: what are its key functions?

- Making the rules that govern the conduct of financial firms in the retail and wholesale spheres
- Granting permissions for non-prudential activities
- Supervising and enforcing compliance with conduct of business rules and the prudential activity within its remit
- Approving individuals to perform:
 - Conduct-related controlled functions within financial firms prudentially regulated by the PRA
 - All controlled functions for firms only regulated by the CPMA
- Performing administrative functions

CPMA: how will it be structured?

- The CPMA will be independent of government
- It will be a company limited by guarantee, financed by the financial services industry
- Government is considering whether to adopt the legal corporate entity of the FSA
- It will take on responsibility for associated bodies:
 - The Financial Ombudsman Service
 - The Financial Services Compensation Scheme
 - The Consumer Financial Education Body
- The Office of Fair Trading's responsibilities may move to the CPMA

PRA/CPMA: the road ahead

- Tougher approach to supervision and regulation
- More interventionist
- More stringent regulation to come
- AML professionals should:
 - Apply higher standards
 - Be prepared for tougher regulation

New regulatory structure: risks

- **Regulatory fragmentation risk**
 - in future firms will have to deal with two authorities (PRA and CPMA)
 - more cost and administration for firms
- **Overlap risk**
 - risk that when one authority changes its rules, it will affect rules of other authority
 - coordination between all 3 bodies is vital
 - further layer of consultation will be necessary to tackle overlap risk

Economic Crime: new ECA?

- Government has provided minimal information on plans for tackling economic crime
- Economic Crime Agency (ECA)
 - Government to consult on whether to transfer responsibility for prosecution of criminal offences (involving insider dealing/market abuse/other criminal law breaches) to a new Economic Crime Agency

What happens in a crisis?

- In the event of a financial crisis:
 - The Bank of England will be responsible for designing and executing most elements of the regulatory and resolution response
 - The Treasury will control any decisions involving the use of public funds
- The government will explore whether, in light of the creation of new bodies, the special resolution regime under the Banking Act 2009 requires amendment or further tools and powers are needed
- The Treasury will continue to stress the importance of consistency at international and European level

Responses to new framework

- Responses to consultation published in November 2010
- 5 key themes:
 - The importance of accountability and transparency for the PRA, CPMA and the FPC. Concern that new framework could result in concentration of power within BoE.
 - The need for the regulatory authorities' core statutory objectives to be balanced and supplemented with other factors. Support for simplification of the Financial Services and Markets Act 2000 (FSMA).
 - The importance of effective coordination between the new authorities to promote consistency and minimise duplication and costs
 - PRA and CPMA will have equal status, with use of PRA's veto only where necessary to protect financial stability

Responses to new framework (Cont'd)

- The need for a strong, coherent markets regulation function within the CPMA.
 - UKLA will remain within the CPMA rather than be merged with the FRC.
- The importance of the European and international agenda during the transition phase and the steady state. Need for FSA, BofE and Treasury to engage positively and constructively with European and international partners.
 - PRA will represent UK in the new European Supervisory Authorities (ESAs) for banking and insurance
 - CPMA markets division will represent UK in European Securities and Markets Authority (ESMA).

What happens next?

- Government to consult on draft legislation in early 2011 to give necessary powers and functions to PRA and CPMA
- A shadow internal structure will be created at the FSA in anticipation of the creation of the new authorities
- The FSA will continue to represent the UK at international forums
- An interim FPC will be established by end of 2010

Questions

- Which authority will be responsible for AML?
 - PRA?
 - CPMA?
 - ECA?
 - Unclear at present
 - Government's preliminary response: FSA's criminal enforcement powers in relation to market conduct should be retained within the CPMA

Practical Steps

- Look out for developments
- Project team for regulatory change
- High standards
- Scoping exercise for Q1 2011
- From “*underlap*” phenomenon to overlap phenomenon:
 - Increased costs and administration

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