Association for Financial Markets in Europe

Consultation response

Power of Direction Over Qualifying Parent Undertakings by the PRA

25th February 2013

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on Power of Direction Over Qualifying Parent Undertakings by the PRA. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76.

We summarise below our high-level response to the consultation, which is followed by answers to the individual questions raised.

afme/ Finance for Europe

Executive summary

In general members are in agreement with the approach being adopted by the PRA in the draft policy statement. However, this new power adds to PRA's range of wide reaching and broad powers, the extent and nature of which should not be underestimated. Previously, the FSA had a range of existing powers which implicitly gave a degree of control over parents e.g. consolidated supervision, approval of controller status, Financial Conglomerates Directive, SIF approval for directors. However, these new provisions create an explicit power which will make it much easier and clearer for the regulators to direct parents to take action and so there are a number of areas where members feel that further explanation/guidance would be beneficial or where there are concerns as to the approach being adopted by the PRA. These points are highlighted in the sections of this document below. As a more general point, PRA must ensure it is transparent in how it exercises this power, the statement of policy goes some way towards achieving transparency but:

- The steps leading up to use of this power need to be more clearly expressed (the ladder of interventions)
- As a new power, many precedents will be set in its early use, therefore the PRA must be transparent and clear about when and how the power has been exercised to aid understanding by firms, their boards and shareholders, and markets.
- The use of such important powers rely on skill and judgement of PRA personnel however the discretion that necessarily entails mean that the PRA's staff must have an even better understanding of a firm's business model and the markets in which they operate.

In addition, the actual mechanics of issuing a direction were not entirely clear from the consultation. It is our understanding that a direction is issued privately to the parent and it not made public.

Members also expected to see explicit reference to interaction of the power with statute and regulatory requirements such as Companies Act and Listing Rules and, local legislation. For example PRA could make a direction not to make an acquisition. The mechanics of such an event and interplay with existing Companies Act requirements need to be clearly thought through and defined before these powers can be implemented effectively. In particular:

1. The obligations and liabilities of directors when putting a proposal arising from a PRA direction to shareholders are not clear. In our example there are tensions between directors' duties under UK Companies Act and meeting PRA regulatory expectations.
2. In this example, the regulators could themselves become "shadow" directors of a listed entity in Stock Markets across the globe (e.g. New York, London and Hong Kong) but due to the UK regulators having statutory immunity they do not risk themselves being subject to bond and shareholder class actions if the steps they take are not in the best interests of shareholders. However, the 'damage' would still be done to the listed entity.
3. Were a direction to be made to, for example, reduce/ not pay a dividend that would not be public information. It is inside information. However, firms have duty of disclosure to other regulators, break clauses in contracts (particularly for capital), etc. PRA must clearly and explicitly address those obligations when issuing any such direction.

1. Draft Statement of Policy – Para 6

AFME member firms note the need for further clarification of the meaning of the phrase "place of business in the United Kingdom". Whilst in many instances it will be obvious that a particular firm is operating from a place of business in the UK there other examples where more clarity is required. For example, does the use of a service company, a legal representative, postal box or similar arrangements based in the UK constitute a place of business for the purposes on identifying a qualifying parent undertaking?

If it is established that a firm has a place of business in the UK, how would this new power works in respect of passporting rights? Would the PRA issue a power of direction in conjunction with the home regulator? Would the firm be assessed on their compliance with the PRA's Threshold Conditions in addition to requirements in home country?

Member firms seek further guidance as to in what circumstances, will the PRA consider issuing directions to an intermediate company. The geographical criteria is one of the elements to consider (e.g. the company must be located in the UK), but would the PRA take into account whether or not the intermediate company has any decisional power/direct link to the firm's governance? This position would conflict with the policy statement contained in para 10, where it is implied that the PRA will look at the ultimate parent undertaking in view of their role as "the centre of power in a group". In the same paragraph the policy states that "A parent undertaking is also usually the only entity that can alter the group structure above and around an authorised firm or remove some barriers to effective resolution". In the case of some intermediate or company which are part of a complex structure, this may not always be the case. Does it mean that in these circumstances, the PRA will not seek to issue directions against that undertaking?

Draft Statement of Policy – Para 9

Section 192 C (2) of the Financial Services Act sets out that in relation to the general condition, the appropriate regulator can give the direction when it considers that it is desirable in order for the FCA to advance one or more of its operational objectives or for the PRA, to advance any of its objectives. Member firms propose that the PRA provide comprehensive guidance on its interpretation of "desirable" in the context of this type of regulatory intervention. The dictionary definition states "wanted or wished for as being an attractive , useful, or necessary course of action" and members believe that in the context exercising a power to direct qualifying parent undertakings the emphasis should be that it is a "necessary course of action" as opposed to simply being wanted or wished for. The use of this word is worrying as it suggests that firms may be held accountable for other than a breach of legal requirements. Principles of good regulation would also require that any directions be proportionate to the risk/reward of the directed action. There should also be an appeals process.

Members would also like further clarity on whether the Power of Directions against a parent undertaking will be used in addition to or instead of, powers which can be used against the firm.

2. Draft Statement of Policy – Para 18

In this paragraph, the policy explains that it may be desirable for the PRA to exercise the power if there is a "single material concern" or several causes for concern over a period of time. Members believe that the policy should clarify whether materiality criteria apply to each element of the series of events or would a number of minor relatively minor concerns be combined such that they become a trigger too?

Member firms believe that further clarity on the meaning of "materiality" in the context of this section should be provided by the PRA.

3. Draft Statement of Policy – Para 21

Member firms have concerns regarding a number of the subsections in this paragraph. In particular:

Section (c) - The PRA has a number of regulatory tools that could be employed against a regulated firm that has failed to comply with a legitimate instruction issued by a regulator. These tools include, if necessary, taking disciplinary/enforcement action against the firm and/or its senior management, public censure or revoking any relevant permissions granted under Part 4A of the Financial Services Act 2012. Given these wide ranging powers it should not be necessary to consider use of a Direction against an unregulated parent company where a regulated firm has failed to comply with a legitimate Direction (note: It looks like this power can be exercised in any circumstances, including where the firm has not failed to comply with a Direction but it may be considered necessary for the advancement of the PRA's objectives. From the wording of this paragraph it is not clear what would be the trigger for the power of direction (e.g. failure to comply with legal requirement, failure to comply with Threshold Conditions or failure to comply with recommendations).

Section (d) – It is not clear on what basis the PRA would judge a firm as "likely to fail to comply" – firms should be given every opportunity to comply with legitimate regulatory instructions. In the event that a firm fails to comply with such an instruction the PRA has access to a number of regulatory tools as outlined above which can be used without the need to issue a Direction against a non-regulated parent undertaking.

Section (g) – It is not clear how by issuing a power of directions against a parent undertaking or an intermediate company, the PRA would achieve quicker results than by attempting to resolve any issue directly with the firm. In practice, any attempt to involve an unregulated parent undertaking is likely to add delays into the process for example:

1. The time taken for the parent company to investigate the background to the Direction with the regulated subsidiary company;

2. Time needed by the parent company to obtain its own legal opinion on the legitimacy of any Direction issued by the PRA including in particular an assessment as to whether the PRA has adequately considered (and exhausted) using its powers over the regulated entity;
3. The need of the UK parent company to assess potential impact on other locally incorporated subsidiaries and their relationship with local competent authorities, with whom necessary discussion may need to be held before taking action to comply with the Direction; or
4. The need of the parent company to discuss any Direction and its subsequent impact with its own parent company located overseas (where applicable).

This paragraph strongly suggests that this power would not be used as a last resort.

4. Draft Statement of Policy – Para 22

For similar reasons outlined above in respect of paragraph 9(g), member firms believe that the use of the Power of Direction Over Qualifying Parent Undertakings is not likely to be the most efficient method of achieving a desired outcome in "stressed circumstances" where time is considered critical.

5. Draft Statement of Policy – Para 23

This paragraph explains that the PRA can impose a requirement by reference to the parent undertaking's relationship with (a) its group; or (b) other members of its group. Does this mean that the PRA, via this tool, can impose requirements on overseas companies that would otherwise fall outside of the definition of a qualifying parent undertaking?

6. Annex 1

Many sections of this Annex 1 refer to "standards expected by the PRA". Member firms would like additional guidance as to what these"standards" are in practice. What objective measures will the PRA use to set any standards? How will the PRA communicate these standards to regulated firms and their qualifying parent undertakings such they have advance knowledge of the standards against which their actions/processes etc will be judged?

The fact that the list is "non exhaustive" it means that in practice the PRA could make directions in any other circumstances. Members believe it would be useful to provide greater clarity on the criteria, thresholds, etc. to be applied in this area.

2nd Bullet point – Member firms believe that the PRA should only consider intra-group transactions to which the regulated firm is a party and not seek to regulate transactions between other group members not regulated by the PRA. Where the PRA has concerns over transactions involving or potentially involving a regulated firm it should, in the first instance, raise those concerns with that regulated entity before any direct contact with the qualifying parent undertaking.

6th Bullet point - PRA should only consider issuing a Direction in respect of remuneration policies that impact directly on persons (including employees, contractors, temporary staff, Directors or other persons deemed to be holding Significant Influence Functions) supporting or controlling the regulated firm. The PRA should not seek to regulate the remuneration policies of other group wide companies/persons that do not involve the regulated firm.

In respect of all powers exercised at group level, we would expect that this would only apply if the firms are PRA regulated/subject to the jurisdiction of the PRA/FCA. What would happen in the event of group companies not registered in the UK but with a place of business in the UK?

8th bullet - Member firms are concerned that the powers of directions could be used in a way that would force them into preferential treatment of UK regulated entities over other foreign group entities when it comes to issues like, for example, capital allocation. This area potentially raise an issue of inconsistency with the Treaty for the Functioning of the European Union ("TFEU") as the UK approach may indirectly discriminate against nationals of other Member States. Until more clarification is provided / or redrafting is made in order to ensure consistency between the TFEU and the UK continuity objective, the PRA should confirm that no action will be taken to protect the UK taxpayer at the expense of group entities regulated in other countries.

7. Annex 2

10TH Bullet point - Directors of unregulated parent undertakings are not, under the current FSA Approved Persons Regime, SIFs. While members do not disagree with regulators' guidance for unregulated parent undertakings to take action against whoever considered as unsuitable for the role, without formal requirements in the rule, this proposal is expected to be received as controversial and difficult to execute. It would be helpful to know if this Approved Persons' Regime is formally marked for a substantial change in the near future, to bring in those directors of unregulated parent undertakings into the Approved Persons Regime going forward.