Association for Financial Markets in Europe

Consultation response

CP12/34 Regulatory Reform: FCA Handbook updates relating to supervision and threshold conditions and statement on the FCA's new power of direction over qualifying parent undertakings

29th January 2013

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on CP12/34 Regulatory Reform: FCA Handbook updates relating to supervision and threshold conditions and statement on the FCA's new power of direction over qualifying parent undertakings. 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.

Executive summary

In general members are in agreement with the approach being adopted by the FCA in the amendments covered by this CP. There are however 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 FCA. These points are highlighted in the sections of this document below.

1. Overview

Member firms would like clarification of the distinction between "FCA-authorised person" used on nine occasions throughout the CP and "FCA-authorised firms" used once on page 29 section 5.23 - are these meant to be different groups?

In addition the PRA / the Bank tend to use "authorised person" and the FCA tends to use "authorised firm". Members ask that wherever possible the PRA and the FCA should use consistent terminology and share defined terms in their respective handbooks. Members view matters such as shared definitions as an example of base level cooperation between the regulators.

2. Changes to the Supervision Manual (SUP 1): The FCA approach to supervision

Q1: *Do you have any comments on how we propose to cover the FCA's new supervisory approach in the revised SUP 1?*

Members would appreciate further guidance/clarity on SUP 1A2.2-"for a firm which undertakes business internationally, the FCA will have regard to the context in which it operates". There are concerns that action taken by FCA could have an unintended impact on group companies regulated in other jurisdictions. It is essential that the FCA have the relevant expertise to assess their operations in light of local regulations?

SUP 1A 3.3 refers to a "peer review process" but it is not clear what peer group is being referred to. Is this process a review of a supervisor's peer group to ensure consistency with regard to supervisory approach or, a review of the firm's peer group to ensure similar firm are treated in a consistent manner?

It appears that the FCA is trying to identify a pattern of risk / trend. It will be helpful to know if such a peer review process is intended to be part of a formal assessment. If so, further detailed clarification is welcome.

If the intended approach is to place firms into peer groups great care will be required to ensure that the individual features of firms are taken into account and that peer groups are not based on simplistic metrics such as number of employees/number of customers/types of products traded etc.

AFME members believe that one of the most important aspects of the new supervisory regime being introduced by the FCA (and the PRA) is the consistency with which supervisory expectations are set and supervisory interventions made. SUP 1A.3.5 explains the importance of a firm understanding of the FCA's evaluation of the risk that particular

firm poses to the FCA' objectives. SUP 1A.3.6 explains that FCA will communicate to the firm concerned risks identified as a result of FCA's supervisory activities and outline a remedial programme intended to address the risks identified. The rule goes on to state that "the FCA considers that it would generally be inappropriate for a firm to disclose its FCA risk assessment to third parties...." and members are concerned that the FCA guidance in this area could restrict the ability of firms to discuss matters of common interest. Such a restriction could reduce the opportunity of achieving the levels of consistency that would benefit the overall regulatory regime.

Whilst it is accepted that firms would be unlikely to share full details of an FCA's risk assessment such as proposed supervisory action there is considerable benefit to be gained from general discussion within the industry. Such discussions may take place on a bi-lateral or multi-lateral basis perhaps under the auspices of a trade association such as AFME or similar organisations. Discussions typically focus on areas of regulatory concern, approaches to particular issues/concerns and assist firms in determining an approach to any particular issue may be appropriate and/or identifying where a particular firm "fits" within its perceived peer group. Discussions are often held under "Chatham House rules" or equivalent agreements to maintain confidentiality.

Member firms would like to continue to participate in the types of discussion outlined above and are concerned that the language used in SUP 1A.3.6 may leave them open to criticism by the FCA. Consequently member firms would like to see SUP 1A.3 amended to make clear that such discussions are acceptable to the FCA.

Whilst members understand the need for each of the regulators to focus on their own statutory objectives they are concerned that there may be occasions where joint meetings may be appropriate. For example, when considering matters such as Approved Persons, Corporate Governance and Systems and Controls etc that may be of interest to both regulators the need for separate meetings should be avoided.

For dual regulated firms, organising two sets of meetings, one for the PRA and the other for the FCA with the senior management will be very onerous in terms of time commitment from the managers involved and potentially detract from the significant on-going responsibilities those individuals have within the firm.

The regulatory principles set out in the Financial Services Act 2012 (the "Act") in sections 1B 5(a), 3B 1(b) and 3D 1(c) would seem to suggest that when considering such matters the regulators must be mindful of the burden placed upon a firm when undertaking their activities. Member firms are concerned that the final sentence of SUP 1A.3.8 implies that at no stage in the supervisory process will joint meetings between the firm, the FCA and the PRA will be held. Such an approach would not appear to be consistent with the requirements of the Act. Member firms would prefer that wherever the particular topic under discussion warrants input from the firm and both regulators the potential for joint meetings be considered the norm rather than individual meetings between the firm and each regulator.

3. Changes to the Supervision Manual (SUP 7): Individual requirements

Q2: Do you have any comments on our proposals to amend SUP 7?

Members have concerns in respect of when the variation powers will be exercised in practice. The Scenarios included in 7.3.2 (G) are very wide. In 7.3.2. (2) it is stated that the FCA can vary a firm's permission is the firm becomes involved with new products which present risks not adequately covered by existing requirements. This would means that there could be a change of policy which would see a current legitimate product "outlawed". While members understand the need for the FCA to act on a pre-emptive basis, members believe that variation to a Part 4A permission should be the last resort considering the new proposed powers on product intervention.

In 7.3.4 it is stated that the FCA will seek to give a firm reasonable notice of intent to vary its permission. It would be useful to have clarity on what is deemed to be a "reasonable" notice.

4. Changes to the Threshold conditions sourcebook (COND)

Q3: *Do you agree the COND Sourcebook should be retained in the FCA Handbook?*

Yes, AFME members welcome and support the retention of the COND section of the FCA Handbook.

Q4: *Do you agree with the amendments to COND as set out in the Instrument at Appendix 5?*

Members agree with the amendments but would prefer the layout/sequence to be updated into a more logical order where all of the conditions that apply to a firm regulated by FCA only are grouped together. For example, Section 2.7.1 and 2.7.2 would be better placed alongside all of the other conditions related to firms regulated by FCA only.

In 1.2.3 G (1) it is not clear when the FCA can use its own initiative powers. Current wording states: "If, among other things, a firm is failing to satisfy any of the FCA threshold conditions...". Firms needs certainty on what requirements they need to comply with. From this wording, it appears that a firm may be asked to do or stop to do something, despite it complies with the Threshold conditions and the law.

Q5: *Do you agree that the Instrument sufficiently draws the distinction between the guidance that applies to dual-regulated firms and that which applies to FCA-only regulated firms?*

The text setting out the application of COND is complex and difficult to read. Member firms would like to see a table included in the rules which sets out clearly the different types of firm along one axis (e.g. FCA Only, FCA/PRA, Incoming EEA or incoming Treaty firm). The second axis to show the various Threshold Conditions with an indication against each firm type/condition point on the matrix indicating whether or not the condition applies (foot notes could be used to explain any particular anomalies where necessary). A similar table should focus on insurance related activities to aid firms active in that sector of the market.

Q6: *Do you have any comments on the proposed guidance to the new Business Model TC?*

Notwithstanding the different objectives of the PRA and the FCA the review of a business plan that relates to a firm carrying on, or seeking to carry on, a PRA-regulated activity is an example where there is a clear overlap between the FCA and the PRA supervisory activities.

As indicated in our response to Question 1 above member firms would hope that the regulators will coordinate their activities when undertaking reviews of a firms business plan in such a manner as to reduce the burden on a firm so far as is practicable consistent with the requirement set out in section 3B (1)(b) of the Act. Members believe that the coordination between the PRA and the FCA should extend to the type of data (and associated data formats) requested by the regulators in respect of a firm's business plan to ensure the burden placed on a firm in this area is kept to a minimum.

5. FCA powers over qualifying parent undertakings

Q7: Do you have any comments on our draft statement of policy on using the power of direction?

6. Annex 1 – Compatibility statement

No comments on this section.

7. Appendix 1 – Revised Chapter 1 of the Supervision Manual (SUP 1A)

No comments on this section (see answers to Q1 above).

8. Appendix 2 – Designation of the Supervision Manual (SUP 1A)

The table at Appendix 2 giving details of the designation of each rule in SUP 1A should be corrected to show SUP 1A.1 etc rather than the SUP 1.1 as at present.

9. Appendix 3 - Changes to Chapter 7 of the Supervision Manual (SUP 7)

No comments on this section.

Appendix 4 – Designation of changes to Chapter 7 of the Supervision Manual (SUP 7)

Please clarify whether Rule 7.2.4.B has been omitted from the designation table on purpose (if so, please explain the rationale) or whether the omission is a simple typographical error.

10. Appendix 5 – Changes to the Threshold Conditions sourcebook (COND)

Members would appreciate further guidance of the FCA's expectation with regard to business plans and the need for such documents to be maintained in a specific style or format. Whilst firms generally produce or update their business plans on a regular basis a significant number of firms have been in operation for many years and consequently may never have submitted a full application for Part 4A permission with a business plan in the format implied by rule 1.1.3E.

In particular members would appreciate confirmation that there is not a requirement to reformat existing business plans or collate information is such a way as to conform to the specific requirements of the application pack referenced in rule 1.1.3E. Confirmation that FCA will accept that firms maintain their business plans in a variety of formats which are reviewed/updated to differing timeframes that reflect the needs of the particular business would be appreciated.

Members accept that where FCA review an individual firm's business plan and identify areas where the regulator feels the plan is deficient action can be taken by the firm and/or the regulator as appropriate.

Member firms would like to see further clarification of the matters to be considered under rule 1.3.3.B particularly as to what FCA considers being "relevant matters", what type of entities would be considered relevant (e.g. group companies and/or their senior management, competitor companies or other independent bodies such as consumer groups). In addition clarification is sought on the geographic scope to be applied when considering relevant matters.

Typographical error in 1.3.5 (1) where "is missing from the consumer definition.

11. Designation of changes to the Threshold Conditions sourcebook (COND)

No comments on this section.

12. Appendix 7 – Draft FCA statement of policy on the use of the power to direct qualifying parent undertakings

The key issue arising from the proposed use of the FCA's power of direction is when and how this is intended to be exercised. Qualifying parent undertakings may be located in the UK, but implications of a direction will be felt internationally. Subsidiaries and branches of the group comply with local regulations and keep regulatory relationship in their jurisdictions. Members would like to highlight the importance of assessing impact and to encourage the FCA to choose a most suitable tool after exhausting other options such as regulatory action to the UK regulated firms.

Member firms would like to see 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?

While Section 192C (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 would like to see FCA provide some 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.

Member firms would like to see clarification as to the manner in which FCA would seek to apply the power of direction where the FCA regulated entity is the branch office of an incoming EEA firm or an incoming treaty firm, a branch of a third country firm and the parent undertaking is the subject of regulation by a relevant overseas authority.

Members would appreciate further guidance in a number of areas:

- It is not clear when the FCA will use the powers against the ultimate parent undertaking or against an intermediate parent undertaking;

- Would this power be used in addition to powers against regulated firms or as a last resort, if firms do not comply with requirements ;

- In the case of complex group arrangements, would the FCA exercise this power against the immediate parent undertaking or more than one company?, and,

- When the ultimate parent undertaking is located outside the UK, would the FCA have due and proper consideration to local laws which would have had an impact on the company's strategy?

In General condition, (paragraph 9, Appendix 7), it is stated that non compliance with the law is only one of the examples in which the FCA may use its power of directions. As above, firms need to have certainty of what they can and cannot do. Members would like further guidance/examples of when FCA will use this power in the absence of specific legal constraints.

13. Annex 1 – Non-exhaustive list of possible scenarios in which the FCA may consider exercising the power of direction

5th Bullet Point – In many instances a regulated firm may be a private or close company where the holding company represents the entire or significant majority of the shareholders in a regulated firm. In such situations it is reasonable to expect the regulated entity's board to take due account of the holding company directors. By way of example a parent company may require a regulated firm to maintain a presence in a particular market segment where the regulated firm (acting alone) may have decided to exit that particular area of the market. Members believe that it should be made clear that the imposition of a Direction by FCA should only be made in circumstances where there is clear evidence to show that the influence being applied by holding company directors is inappropriate in the context of the regulated firms activities and their subsequent impact on FCA objectives.

6th Bullet Point – Members consider that the FCA should take all other practicable steps before using the regulatory tool of issuing a direction to a qualifying parent undertaking. All such steps should be exhausted before getting to the point of issuing the direction. Members are not convinced that taking regulatory action against the parent would typically result in an optimal solution for consumers.

It is by no means common that a group board would be directly involved in the oversight of the development of new products by a subsidiary company. FCA has direct powers over the regulated entity which can be used to ensure that any new product developed by the firm meets regulatory expectations and consequently this particular scenario would appear to be unnecessary. If the scenario is to be retained in Annex 1 the FCA is asked to provide more specific guidance on why the scenario is deemed necessary.

14. Annex 2 – Non-exhaustive list of possible Directions which the FCA may consider making.

1st Bullet Point – Member firms would like to see further guidance/clarification from FCA on the proposed scope of this Direction. As drafted it would appear that FCA envisages a situation where it would potentially exercise powers over the activity of a non-regulated company in areas of business that fall outside the scope of the regulation of financial services in the UK. There is a risk of a parent / a sister firm of the UK regulated firm not being able to follow an FCA Direction that potentially conflicts with local regulatory requirements and expectations. We would encourage the FCA to consider international implications and to coordinate with fellow regulators which could be stakeholders if such a Direction is issued.

3rd Bullet Point – Taking into account our comments above on the 6th bullet point (i.e. the ability of FCA to restrict where appropriate the activities undertaken by an FCA regulated firm), this Direction would appear to be unnecessary.