

27 September 2013

Early Intervention Team  
Cross Cutting, Prudential and Early Intervention Department  
PRR Division  
Financial Conduct Authority  
25 The North Colonnade  
London E14 5HS

*By email: [s1k.objectives@fca.org.uk](mailto:s1k.objectives@fca.org.uk)*

### **The FCA's approach to advancing its objectives**

Dear Sir / Madam

We attach our comments on this draft guidance.

We would be happy to discuss these, or any other of the issues covered in this submission with you, or to provide further information about any of the matters which we have raised if that would be helpful.

Yours truly



**Will Dennis**  
**Managing Director**  
**Compliance**

#### **Association for Financial Markets in Europe**

[www.afme.eu](http://www.afme.eu)

London Office: St. Michael's House, 1 George Yard, London, EC3V 9DH T: +44 (0)20 7743 9300 F: +44 (0)20 7743 9301  
Brussels Office: Square de Meeus 38 – 40, 1000 Brussels, Belgium T: +32 (0)2 401 8724 F: +32(2) 401 6868  
Company Registration No: 6996678 Registered Office: St. Michael's House, 1 George Yard London EC3V 9DH

## Response to draft guidance

27 September 2013

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The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the Financial Conduct Authority's draft guidance published in July 2013 entitled **The FCA's approach to advancing its objectives** (the "Draft Guidance"). 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.

### **1. Generally**

AFME welcomes the FCA's transparency and willingness to interact with the public and the industry in publishing this Draft Guidance. We note that responses are required by 27 September 2013 and that final guidance will be issued by early 2014.

We assume that this document does not represent formal guidance until after the FCA has published the promised final guidance on the subject in early 2014.

### **2. Consumers.**

The definition of "consumer" in the Financial Services Act 2012 is as follows (and is so set out at page 45 of the Draft Guidance).

*"..... persons who:*

- *use, have used or may use regulated financial services, or services that are provided by persons other than authorised persons but are provided in carrying on regulated activities*
- *have relevant rights or interests in relation to any of those services*
- *have invested, or may invest, in financial instruments*
- *have relevant rights or interests in relation to financial instruments; or*
- *have rights, interests or obligations that are affected by the level of a regulated benchmark.”*

The Draft Guidance states, however (at page 8), that “*the term ‘consumer’ covers*

- *retail consumers buying financial products or services for their own use or benefit (such as mortgages and ISAs)*
- *retail investors in financial instruments (such as shares and bonds)*
- *wholesale consumers (such as regulated firms buying products or making investments, or issuers looking to raise capital)”.*

The Draft Guidance goes on to say (at page 10) that the FCA “*aims to ensure customers are treated in a way that is appropriate for their level of financial knowledge and understanding*”; and that, when considering how much protection is appropriate for consumers, the FCA must have regard to (page 45):

- *“the amount of risk involved in different kinds of investment or other transactions*
- *the experience and expertise that different consumers may have*
- *that consumers may quickly need information and advice that is accurate and fit for purpose*
- *that consumers should take responsibility for their decisions*
- *that those providing regulated financial services should treat consumers with an appropriate level of care, taking into account the degree of risk involved and the capabilities of the consumers in question*
- *the expectations consumers may have in relation to different kinds of investments or other transactions*
- *any information that the Money Advice Service has provided to [the FCA] in the exercise of the consumer financial education function*
- *any information that the Financial Ombudsman Service has provided [the FCA] with that could help [the FCA] fulfil one or more of [its] operational objectives.”*

The MiFID 1 client categorisation framework states that an investment firm providing a service to a professional client “*shall be entitled to assume that, in relation to the products, transactions and services for which it is so classified, the client has the necessary level of experience and knowledge*”. Furthermore the onus is on professional clients to keep the investment firm informed about any changes which could affect their client categorisation.

MiFID 1 does also set out that should an investment firm become aware that the client no longer fulfils the initial conditions which made it eligible for professional treatment, the investment firm must *“take appropriate action”*. But there is no requirement for a formal annual review, and the normal action is to reclassify.

MiFID 1 is of course currently being revised, with MiFID 2 expected to come into force around 2016; however, the approach to client categorisation is expected to remain largely unchanged.

AFME would be grateful for confirmation that the FCA does not expect sell-side firms to go beyond the MiFID requirements, including confirming that there will be no requirement to assess wholesale clients, such as eligible counterparties and professional clients, as to their different experience and expertise as regards differing products that they are sold.

### **3. Supervision of Wholesale Conduct**

This Draft Guidance explains (page 28) that wholesale conduct is *“how we [the FCA] describe the way market participants interact with each other and conduct their business in wholesale markets (such as banking, insurance and securities). This includes trading or dealing, and the way firms behave when dealing with non-retail clients.”*

This is amplified (page 29) by -

*“[The FCA] have developed an interventionist policy for supervising existing wholesale conduct issues, with a particular focus on:*

- *harm caused by products manufactured in wholesale markets and distributed into retail markets where product features are not transparent or are misleading*
- *poor conduct by firms where differences in expertise causes bias in the wholesale market practices at various points of the value chain that cause harm to the end consumer poor conduct in wholesale activities that affect trust in the integrity of the markets, even where there is no clear direct harm caused*
- *potential disruptions to markets working properly caused by firms failing or failing to meet their obligations.”*

AFME and its members find this list unclear and would welcome concrete examples. We are firmly of the view that clarity of regulation is important for market integrity.

### **4. Prudential**

AFME notes that the policies and principles behind the FCA approach to prudential regulation aim to protect consumers and markets from (page 26):

- *“firms acting inappropriately when dealing with consumers or other market counterparties*

- *firms under financial strain*
- *firms failing and/or leaving the market.”*

Prudential policy sets standards that aim to give firms a degree of resilience, and increase consumer trust in a firm’s creditworthiness, substance and commitment. FCA states that it takes a proportionate approach to the standards that it applies, taking into account the nature, scope and complexity of the risks that firms pose to its objectives.

When determining the policies and principles by which the FCA carries out its prudential role, FCA state that they will look at the following risk-based principles (page 27):

- *“introducing or enhancing prudential standards for those activities and firms where consumer harm is more likely to arise*
- *introducing or enhancing prudential standards for the firms and activities where market disruption is more likely to occur if a firm gets into financial difficulties or fails. For example, is the firm particularly important in its market and would it have a considerable impact on consumers and markets if it failed?*
- *introducing or enhancing prudential standards for firms and activities that may be costly to wind down if the firm fails*
- *an increased emphasis on prudential and financial monitoring and reporting*
- *identifying which prudential standards, and financial and prudential reporting requirements work best, by looking at the level of risk posed by the regulated activity; for example, by placing a strong emphasis on monitoring liquidity risks or ensuring firms hold a minimum amount of liquid resources.”*

AFME believes that further consultation should take place before the FCA finalises any detailed policy requirements on prudential regulation. AFME notes (from FCA Policy Development Update, August 2013) that FCA plans to issue a policy statement to CP11/16 (Recovery and Resolution Plans) but believes that with the differing objectives of the FCA from those of its predecessor entity the FSA, further consultation is now necessary.

The recovery and resolution plans required by the PRA have been extremely onerous on those firms prudentially regulated by the PRA. The firms regulated prudentially by the FCA are generally smaller than those so regulated by the PRA and, given that the two regulators’ objectives are materially different from each other as well as from those of the FSA, AFME would propose that such plans are only required of firms where the FCA reasonably perceives them to be high risk to the FCA’s objectives.

## 5. Competition

In relation to the FCA's new competition objective, a number of examples of the market conduct features that, the FCA perceive, could inhibit or distort competition are given at pages 38/39, including but not limited to:

- *“Market power held by suppliers - where rivalry is restricted because it is difficult for new organisations to enter the market or to grow rapidly, for example, as a result of low rates of consumer switching, network effects where the value of the service grows more people use the service, strategic behaviour by established firms, or their reputation.*
- *Problems in the flow of information between market participants – where suppliers cannot obtain the information they need on consumers, or consumers cannot obtain the information they require on the services available.*
- *Low switching rates – understanding the reasons why more consumers do not switch suppliers, including whether suppliers artificially raise the perceived costs and risks of switching, in turn preventing markets from working well.*
- *Costs or benefits to third parties – costs or benefits not captured in a product's price that mean that too much or too little of that product is produced or consumed.*
- *Problems in the way consumers or firms make decisions – resulting in situations where what consumers receive is not what they need, they pay too high a price for a service, or where consumers' behaviour does not adequately constrain suppliers.*
- *Too little consumption – understanding why potential consumers or groups of consumers do not buy certain financial products. This could reflect problems in accessing financial services, including a lack of consumer awareness or understanding. It may also be because products are unsuitable or because there are unnecessary, anti-competitive restrictions on the availability of products.*
- *Existing regulation – when existing regulatory measures have adverse effects on competition, for example, through making it more difficult for firms to enter or grow.*

Again, AFME members seek clarity. By way of example only, the first statement above about a firm's reputation is, in our submission, erroneous. Deliberate behaviour by a firm designed to restrict competitors from entering the market may well be capable of criticism, but it is hard to see why a similar effect being generated merely by the firm's reputation should be. A good reputation is built up over time, and is an entirely valid reason for a purchaser to choose one supplier over another.

The FCA describes its relationship with the OFT (and presumably also therefore with the new Competition and Markets Authority) as *“complementary and to a limited degree overlapping roles”* and states that one of the two organisations will take the lead on any given matter. AFME asks for confirmation that firms will not face double jeopardy.