Briefing

Financial Services Series
#1

October 2013

Welcome to the first in our Financial Services Series, monthly bulletins for the regulated financial services sector dealing with important aspects of regulation.

The primary focus of the bulletins will be enforcement (and how to avoid it!). However, we will also cover important aspects of the wider relationship between the Financial Conduct Authority (FCA) and regulated firms. Over the course of the next 12 months, the intention is to provide practical tips for the smooth management of the regulated firm's relationship with the FCA.

In this month's bulletin, we:

1. look at some of the issues with dual regulation by the FCA and Prudential Regulation Authority (PRA); and
2. comment on the change in focus at the FCA together with early indications of how the new approach is affecting firms.

Dual regulation in practice

Many firms are solely regulated by the FCA but those that are dual-regulated such as banks and insurance companies now have the burden of dealing with two regulators. The operational objectives of the regulators differ. The FCA has three operational objectives: securing an appropriate degree of protection for consumers (including wholesale consumers); protecting and enhancing the integrity of the UK financial system; and promoting effective competition in the interests of consumers in the markets for financial services.

The PRA has as its objective the promotion of the safety and soundness of those firms which became subject to regulation by both the FCA (for conduct of business) and the PRA (for prudential regulation) principally by minimising any adverse effects of firm failure on the UK financial system and ensuring that firms carry on their business in a way that avoids such adverse effects.

Dual-regulated firms have naturally been concerned that there might be adverse consequences such as conflicting communications, delays and duplication caused by the need to deal with two regulators rather than one, leading to an increase in the cost of regulation.

The FCA and PRA have a duty under the amended Financial Services and Markets Act (sections 3D and 3E) to co-ordinate in carrying out their responsibilities and maintain a memorandum describing how they will comply with this duty. This memorandum is at **http://www.fca.org.uk/your-fca/documents/mou-between-the-fca-and-the-pracoordination**.

It is too early to give a detailed assessment of whether or not the concerns of dual-regulated firms are well founded. However, the potential for duplication, delay or confusion (and therefore increased cost) may arise wherever a firm has to communicate with two separate regulators or where there needs to be communication and co-ordination between the FCA and PRA. Here are a few examples of possible areas:

- **Supervision of dual-regulated firms:** Banks and insurers will be required to communicate with two regulators rather than one.
- **Data sharing:** the FCA and PRA will be working together to ensure that the regulatory reporting process for dual-regulated firms is efficient. Firms should only be asked to provide data sets once. The data is then shared between the regulators. Any practical problems with data-sharing systems may cause additional complications and cost. This applies to dual-regulated firms but the FCA has stated that data of other firms will also be shared where it is considered necessary to ensure that each regulator has a complete view of the market.
- **Enforcement:** there are specific provisions in the Memorandum on co-operation for the regulators to seek consent, consult or notify one another at various points in enforcement matters. These requirements for co-ordination between the regulators raise the possibility of delay and complication.

- **Resources:** for enforcement matters, the PRA does not have an equivalent level of resources to the FCA. This may in practice lead to the additional complication of some parts of the PRA's enforcement work being out-sourced back to the FCA.
- **Unauthorised regulated activities:** the FCA is solely responsible for enforcement action in this area but must notify the PRA before investigating or taking legal proceedings. The PRA can ask the FCA to take action but the FCA is not obliged to comply with the request. Again, where consultation or co-ordination between the two regulators is required, the possibility exists for complication 4and delay.

The FCA's change of approach and new focus

Martin Wheatley, Chief Executive of the FCA has summarised the priorities and objectives of the FCA on various occasions since the new regulatory structure was put in place, including in his speech on 9 July 2013 to the ABI Biennial Conference in London (**http://www.fca.org.uk/news/speeches/100-days-of-the-fca**)

Interesting indications of priority include:

- The cultural changes at the FCA to introduce a more demanding and proactive approach to regulation.
- The detailed assessment of firm's business models as part of supervision.
- A willingness to make early interventions and to make judgments on products, services and, in particular, on fairness to consumers.
- Pursuing the FCA's new operational objective to promote effective competition in the interests of consumers.
- Continuing focus on the importance of holding senior managers responsible in connection with significance influence functions ("**SIF**") and the setting of proper culture within firms. (The changes to the SIF regime following the introduction of the dual-regulation FCA/PRA regime will be examined in a later bulletin of our Financial Services series.)

Early anecdotal evidence suggests that the effects of a more forceful approach by the FCA is being felt in some areas of the industry. A clear example of the FCA using its new powers and regulatory approach is its "General insurance add-on market study". In its first market study under its new competition objective, the FCA is reviewing GAP insurance, home emergency, gadget, travel and personal accident and accident cash plans to identify whether problems of competition exist and, if so, how proper outcomes for customers can be promoted and protected. The initial results of the study are due for publication in early 2014.

Insurance add-ons have already been in the regulatory limelight with the Swinton Group being fined £7.38 million for mis-selling of these products.

Other examples of enforcement action illustrating the FCA's priorities include:

Senior managers/SIFs: success in defending action taken against against significant influence function holder Christopher Willford (formerly of Bradford & Bingley) in judicial review proceedings (see **http://www.burges-salmon.com/practices/disputes_and_litigation/financial_services_disputes/news/news_item.aspx?id=11051**)

Early intervention: immediate intervention where serious weaknesses were found in how a firm managed its high risk PEP (Politically Exposed Person) accounts. The firm was required to carry out an immediate remediation exercise on its anti-money laundering controls and to stop taking on new high risk PEPs until new controls were put in place. See the FSA's Enforcement Annual Performance Account **http://www.fca.org.uk/static/documents/annual-report/fsa-enforcement-performance-account-2012-13.pd**f

Practical tips

Given the re-shuffling of regulatory priorities and new emerging themes, it is more important than ever for firms to keep abreast of upcoming regulatory issues. There is a lot of material to keep on top of. Overleaf are some potentially helpful resources:

Resource	Further details	Hyperlink
The FCA's approach to advancing its objectives	Published July 2013 (under s2K FSMA)	http://www.fca.org.uk/static/documents/fca-approach-advancing-objectives.pdf
FCA Risk Outlook 2013	Published 25 March 2013	http://www.fca.org.uk/static/fca/documents/fca-risk-outlook-2013.pdf
FCA Business Plan 2013/14	Published 25 March 2013	http://www.fca.org.uk/your-fca/documents/business-plan/bp-2013-14
Thematic reviews on products and issues	e.g. mobile phone insurance; insurance conflicts of interest	See various on FCA website
Market studies under FCA's competition powers	e.g. GI add-ons; cash savings accounts	See various on FCA website
Dear CEO Letters	e.g. asset management (FSA, November 2012)	See various on FCA website

Contacts

Kari McCormick, Tim Pope, and Thomas Webb advise clients on financial services disputes and regulatory matters, including enforcement. If you would like further information on the content of this article please contact them.

Kari McCormick

Partner

DDI: +44 (0)117 939 2259

Mobile: +44 (0)7917 284190

kari.mccormick@burges-salmon.com

Tim Pope

Senior Associate

DDI: +44 (0)117 939 2230

Mobile: +44 (0)7968 225096

tim.pope@burges-salmon.com

Thomas Webb

Senior Associate

DDI: +44 (0)117 307 9676

Mobile: +44 (0)7794 030898

thomas.webb@burges-salmon.com

BRM0683 10 13