Policy briefing

April 2013

The UK's New Financial Services Regulatory Landscape

Summary

A new regulatory regime has been established in the UK. Following the passage of the Financial Services Act 2012 the ground was set for the abolition of the Financial Services Authority and the creation of three new regulatory bodies: the Financial Conduct Authority, the Prudential Regulation Authority and the Financial Policy Committee. This new regime came into being on 1st April 2013.

Financial Conduct Authority (FCA):

- The FCA has an overarching strategic objective to "ensure that the relevant markets function well".
- It also has three operational objectives:

  Consumer protection: securing an appropriate degree of protection for consumers.

  Integrity: protecting and enhancing the integrity of the UK financial system.

  Competition: promoting effective competition in the interests of consumers in the markets for: regulated financial services and services provided by a recognized investment exchange.

- The FCA will take a more proactive approach, including taking action early, before consumer detriment occurs.

Prudential Regulation Authority (PRA):

- The PRA is responsible for promoting the safety and soundness of systemically important firms, including insurers, and ensuring policyholders are protected in the event of a firm's failure.
- Its approach to regulation and supervision has three characteristics:

  Judgement-based: using judgement in determining whether financial firms are safe and sound.

  Forward-looking: assessing firms not just against current risks, but also against those that could plausibly arise in the future.

  Focused: focusing on those issues and those firms that pose the greatest risk to the stability of the UK financial system and policyholders.

Financial Policy Committee (FPC):

- A committee within the Bank of England responsible for horizon scanning for emerging risks to the financial system as a whole and providing strategic direction for the entire regulatory regime.
- The FPC has the power to use so-called "macro-prudential tools" to counteract systemic risk. The tools could include imposing leverage limits on banks or enforcing particular capital requirements for given asset classes.
- The Bank of England is now in charge of micro-prudential and macro-prudential regulation, on top of its existing responsibilities for monetary policy, and as a result is fast becoming one of the world's most powerful central banks.

1. Background

Overview

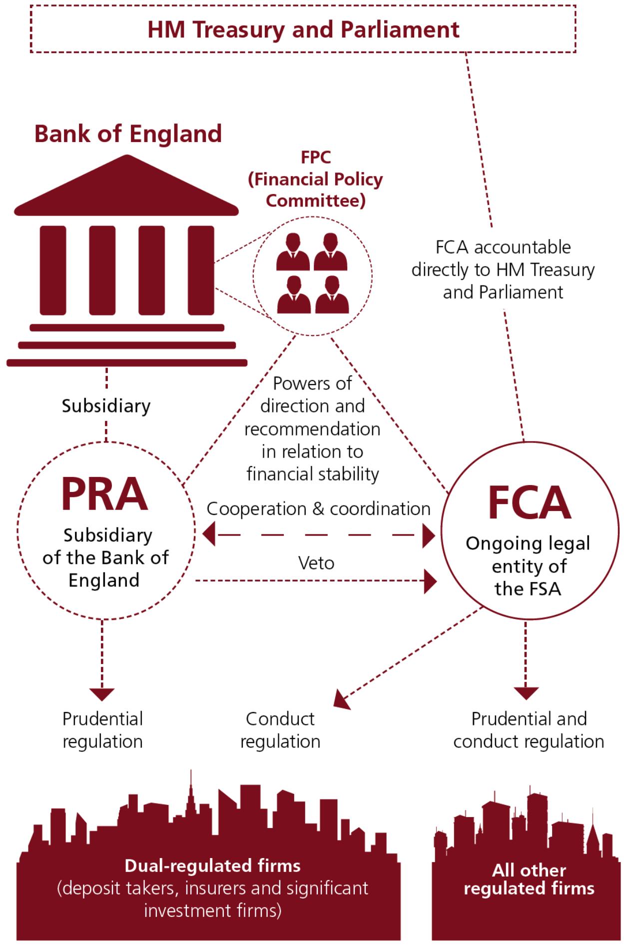
On 1 April 2013, the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) officially came into force. The two regulators replaced the Financial Services Authority under the Financial Services Act which was passed in December 2012.

Since its election in 2010 the Coalition Government had been overhauling the UK's financial regulatory framework. The Financial Services Authority was disbanded and responsibility for financial stability passed to the Bank of England. Within the Bank now sits the **Financial Policy Committee (FPC)**, responsible for horizon-scanning for systemic risks and the **Prudential Regulation Authority (PRA)** responsible for the solvency and resolution of systemically important institutions. The **Financial Conduct Authority (FCA)**, is responsible for ensuring consumer protection and markets regulation, as well as prudential supervision of smaller firms.

Latest developments

Following the passage of the Financial Services Act in December 2012, the Financial Conduct Authority and Prudential Regulation Authority came into force and became fully operational on 1 April 2013.

Figure 1: The New Regulatory Structure



Financial Conduct Authority Diagram, from FCA Business Plan 2013/14, p.58

2. Financial Conduct Authority (FCA)

Chief Executive: Martin Wheatley

Scope

Shortly before coming into force, the FCA published its first Risk Outlook (RO) and its Business Plan for 2013-14. Both documents provide significant detail on the regulator's approach to regulation and supervision and set out its priorities for the coming year.

The FCA regulates about **26,000 firms**. This includes:

- **23,000** firms solely regulated (for prudential **and** conduct issues) by the FCA. These are firms that are deemed of limited systemic importance. Examples include: personal investment firms, investment management firms, mortgage or insurance intermediaries, authorised professional firms, providers of market trading infrastructure, and non-bank mortgage lenders. It will also include Lloyd's members' agents and Lloyd's brokers.
- Over **2,000** firms purely for conduct of business issues. These firms, deemed to be systemically important are prudentially regulated by the PRA and conduct regulated by the FCA. They include banks, building societies, credit unions and general insurers and life insurers, Lloyd's and Lloyd's Agents.
- **1,000** firms regulated under other legislation. These are electronic money institutions and payment institutions.

The FCA has also taken over the FSA's former responsibility for the Financial Ombudsman Service, the Money Advice Service, and has responsibility for the Financial Services Compensation Scheme.

Objectives

The Financial Services Act 2012 states that the FCA has an overarching strategic objective to "ensure that the relevant markets function well", as well as three operational objectives:

- **Consumer protection**: securing an appropriate degree of protection for consumers.
- **Integrity**: protecting and enhancing the integrity of the UK financial system.
- **Competition**: promoting effective competition in the interests of consumers in the markets for: regulated financial services and services provided by a recognized investment exchange.

The FCA and PRA also have two "have regard to" duties:

- Efficient and economic use of resources.
- Proportionality in relation to consumer responsibilities and transparency.

Strategic priorities

The Business Plan for 2013/14 sets out how the FCA will meet its strategic priorities, which are:

- Mitigating the three key forward-looking risks from the Risk Outlook – inherent factors, structures and behaviours, and environmental factors.
- Dealing with its operational objectives of: delivering consumer protection, enhancing market integrity and building competitive markets.
- Addressing crystalised risks, such as PPI and issues surrounding LIBOR.

Approach to regulation

- **Product intervention and governance**: the FCA will be more proactive and "intervene earlier in the product's life span and seek to address root causes of problems for consumers." The FSA had begun this work with its review of the retail development of structured products. The FCA is continuing this and has already confirmed its approach to temporary product intervention rules.
- **Super-complaints**: the FCA will become a body able to review and react to detailed submissions by consumer groups. Currently only the Office of Fair Trading can receive these "super-complaints" highlighting systematic problems in particular markets. Previous submissions have led to inquiries from the Competition Commission into payment protection insurance and extended warranties.
- **Competition powers**: the FCA has a new competition objective: "to promote effective competition in the interests of consumers". This will mean that (a) firms must compete for business by offering better services, better value and types of products that customers want and need; and (b) prices offered are in line with costs.
- **Product innovation**: Firms will innovate and develop new products over time and the FCA will draw a distinction between "good" innovation that meets consumers' genuine needs and other types that exploit consumers.

FCA approach to supervision

The Business Plan provides information on how the FCA will supervise firms. As has been made clear in the run up to its creation, the FCA will take a proactive approach to regulation, looking to address issues before they impact consumers. There will also be a greater focus on business model and strategy analysis.

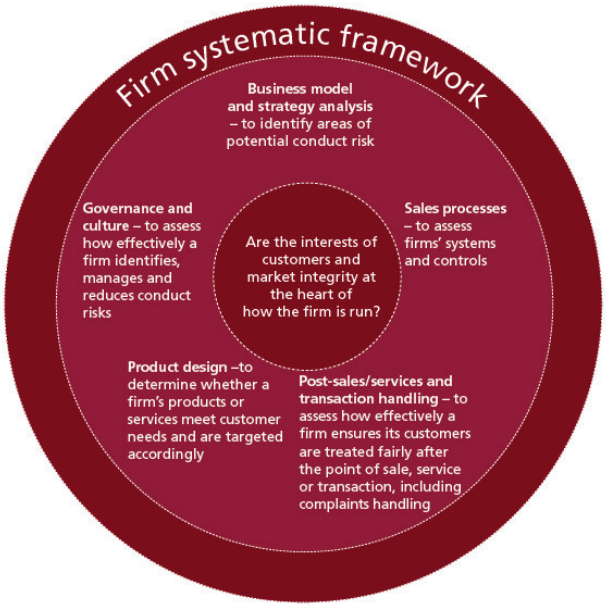
A new supervisory framework replaces the former ARROW system. It comprises five key pillars: the Firm Systematic Framework, wholesale conduct supervision, issues and product work, event-driven work, and thematic supervision.

1. Firm Systematic Framework

As part of the FCA's supervisory framework, the regulator has created the Firm Systematic Framework (FSF). The FSF allows supervision to focus on the key conduct risks and covers all types of firm. It will consider potential harm to consumers as well as the impact a risk could have on the market. To begin with the FSF will be used with the largest retail deposit takers. Then it will extend to all firms in three of the four risk categories:

- large retail banking and insurance firms (which the FCA call Category 1 or C1 firms);
- firms in all sectors with a large retail customer footprint or wholesale market presence (C2), and
- mid-sized firms across all retail and wholesale sectors (C3).
- the FSF will not extend to Category 4 (C4) firms: retail and wholesale firms with a smaller footprint.

Figure 2: FCA Supervisory structure (replacing the former ARROW II system)



Financial Conduct Authority diagram. From FCA Business Plan 2013-14, p.33.

2. Wholesale conduct supervision

The FCA will take a "more assertive and interventionist approach" to risks cause by wholesale activities. This will include intervening when it believes that conduct could have a detrimental impact on consumers. The regulator is very aware what happens in the wholesale market can feed through to retail markets – and that risks within wholesale are driven by the same factors as those in retail.

3. Issues and product work

The FCA will also conduct firm-specific and industry-wide thematic reviews. They plan to undertake detailed work, with the support of industry practitioners, to investigate what causes poor behaviour and how standards can be improved. We await more details of this strand of work.

4. Event-driven work

The regulator will respond faster and more decisively to emerging problems regarding wholesale and retail conduct risks. They will have a consistent process to ensure that 'event-driven' cases (such as alleged misconduct raised by a whistleblower) are dealt with quickly and appropriately.

5. Thematic supervision

In 2013-14, the FCA will be investigating incentive structures and corporate culture, as well as other perceived causes of poor conduct.

In focus: the FCA's approach to supervising small firms

The FCA will place firms into four different categories according to size and type of customer base (i.e retail/wholesale) ranging from those firms with a large number of retail customers (C1 firms) to "smaller firms including almost all intermediaries" (C4).

C4 firms will experience the least intrusive regulation of all. But supervisors will still be looking for small firms to identify and take action to reduce risks to consumers. This new framework consists of:

- C4 firms are classified as '*flexible portfolio*' firms which means they will be supervised by a team of sector specialists and not have a dedicated supervisor.
- A C4 firm will be subject to a 'touch point' once during a 4 year cycle to determine how it runs its business, This could range from a roadshow, an interview, a telephone call, an online assessment, or a combination of these. The exact interaction will depend on our assessment of the risk such firms pose to our objectives.
- The FCA will want to see how firms identify and take action to reduce risks to their business. Only those C4 firms deemed to pose a sufficiently high risk to our objectives will be the subject of further firm-specific proactive work.

Whilst the supervision of small firms will be relatively light-touch by comparison to larger firms, the degree of intrusiveness from the regulator will depend on the ability of small firms to evidence best practice in the interests of customers. Similar to large firms then, small firms must consider the appropriateness of employees training and competence, the governance of incentive schemes, and the kinds of systems and controls necessary to resolve potential conflicts of interest if they want to successfully navigate the new regulatory regime.

Earlier Intervention

As noted above, the FCA will have new powers to intervene to prevent detriment occurring. The Financial Services Act 2012 confirms a number of regulatory initiatives to shift the balance from tackling the symptoms of consumer detriment to the 'root causes'. Examples include:

Banning Products (applies to the retail sector)

- Where the FCA identifies a serious problem with a product or product feature, it is able to take timely and necessary steps to ban it.
- The legislation enables the FCA to make temporary product intervention rules without prior cost-benefit analysis or consultation valid for up to 12 months.
- The FCA is required to consult on a set of principles governing the circumstances under which it will use this power.
- The FCA is only be allowed to use its product intervention powers in relation to retail customers.

Withdrawing Misleading Financial Promotions

- The FCA is able to take action in relation to misleading financial promotions.
- The FCA is able to disclose the fact that enforcement action against a firm or individual has commenced.
- The FCA is required to alert a firm to its proposed course of action, and to allow for and consider representations by firms before publishing any details of its action.

Publication of Enforcement Action

The FSA was starting to be more proactive about enforcement, and 2012-13 had seen a marked increase in the intensity and incidence of enforcement actions.

The FCA is driving this forward with even greater intensity, clarifying its approach in both the Risk Outlook and the Business Plan. It said it will be bringing more enforcement cases and pressing for tougher penalties, and being more willing to pursue cases against individuals including senior management.

It will be allowed to publish the fact that a warning notice has been issued about a firm as well a summary of the notice. This new power will be available to both the FCA and PRA.

In making a decision about whether or not to disclose the warning notice, the regulator must consider a number of factors, including whether publication of the information would be unfair to the person whom the warning notice relates.

Market intelligence gathering and research

The FCA's new **Policy, Risk and Research Division** will "combine research into what is happening in the market and to consumers with better analysis of the type of risks where they appear." It will be the "radar" of the organisation.

Authorisation and Approvals

The FCA will continue the FSA's authorisation function largely unchanged. It will focus on the proposed business model, governance and culture, as well as the systems and controls the firm intends to put in place especially over:

- Product governance.
- End-to-end sales processes.
- Prevention of financial crime.

The FCA will also work closely with the PRA in considering applications to approve individuals to roles which have a material impact on the conduct of a firm's regulated activities. The FCA will seek to assess that applicants have a good understanding of how to ensure good outcomes through:

- Corporate culture.
- Conduct risk management.
- Product design.

In focus: the FCA and PRA Handbooks

Following the splitting of the FCA and PRA, the former FSA Handbook has itself been split into its Financial Conduct and Prudential Regulation sections. However the content of the Handbook material and organisation into subject matter blocks are exactly the same as it was under the FSA:

- The FCA Handbook contains a glossary and 47 assorted sourcebooks, rulebooks, guides and manuals across nine subject blocks such as high level standards, prudential standards, business standards, etc.
- The PRA Handbook contains a glossary and 20 such publications into seven subject blocks.
- Some of the subject matter reflects the fact that FCA will be prudentially regulating a large number of small firms, and the PRA will carry out some conduct of business regulation.
- For ease of use, the regulators have established a single website containing both handbooks: www.fshandbook.info/FS/
- The regulators have also assembled a combined handbook for users familiar with the Handbook's organisation under the FSA. The site also contains links to other resources such as EUR-LEX for European legislation.

Accountability

- The FCA is required to report annually to Government and Parliament.
- There is oversight of the FCA's work by a Board appointed by Government with a majority of non-executive directors.
- The Financial Services Act 2012 contains a provision for independent reviews on the efficiency and effectiveness of the FCA's use of resources.
- A requirement for the FCA to make a report to the Treasury in the event of a regulatory failure and where this failure was due to the FCA's actions.
- However, it is noted that the obligation to publish a report, and the desirability of transparency, should not impede or prejudice the FCA's ability to pursue enforcement investigations. **In such circumstances, publication would be delayed until enforcement action is completed.**

Engagement with consumers

- The FCA seeks to build a better understanding of consumer behaviour, consumer needs and consumer experiences to shape how it designs its interventions.
- The FCA is to engage more with consumers directly, including through social media, consumer bodies, road shows, focus groups and face-to-face contact.
- And finally, the FCA is to collect and analyse consumer information from other sources such as complaints, including those investigated by the ombudsman, and external commercial, academic and public interest research.

Transparency and disclosure

- The FCA is required to put in place four statutory panels representing the views of **consumers, regulated firms, smaller regulated firms and market practitioners.**
- The FCA will build on the FSA's approach to consultation as part of the rule-making process and will seek to develop more effective ways of getting feedback on proposals, including from consumers and their representatives.
- The FCA will publish more information about its views on markets (key trends, products and services) and the comparative performance of a firm.
- The FCA will recognise that necessary restrictions on disclosure exist in UK and EU law.
- However, where disclosure of information would be incompatible with the FCA's objectives, **the FCA does not have to disclose information.**

In focus: complaints against the FCA, PRA and Bank of England

The new complaints regime for the FCA, PRA and Bank of England is similar to the regime that covered the FSA. In the run up to legal cross over the FSA argued that the system had been an *"effective and efficient way of dealing with complaints"* against the regulator. Key requirements include:

- Regulators must deal with complaints within four weeks and where that is not possible, will arrange a timetable with the complainant.
- The FCA will process complaints submitted centrally even if the complaints are about one of the other regulatory bodies.
- To read more visit: http://www.fsa.gov.uk/static/pubs/policy/ps13-07.pdf

The FCA will be responsible for recruitment of a new Complaints Commissioner, who will come in around April 2014. However, any final decision on the appointment will require agreement by all the three bodies.

FCA Board members

The executive members of the board, as of April 2013, are:

- John Griffith-Jones, chairman;
- Martin Wheatley, chief executive;
- Tracey McDermott, director of enforcement and financial crime;
- Clive Adamson, director of supervision; and
- Lesley Titcomb, chief operating officer.

The non-executive members of the board are:

- Andrew Bailey, chief executive, PRA;
- Sir Brian Pomeroy, FSA Board member;
- Mick McAteer, FSA Board member;
- Amanda Davidson, FSA Board member;
- Jane Platt, chief executive, National Savings and Investments;
- David Harker CBE, former member of the FSA's Consumer Panel;
- Amelia Fletcher, former chief economist, Office Fair Trading.

3. Prudential Regulation Authority

Chief Executive Officer: Andrew Bailey

Scope

The Prudential Regulation Authority (PRA) is a part of the Bank of England and responsible for the prudential regulation and supervision of all "systemically important firms" – those firms that pose a risk to the financial system were they to fail. This covers all institutions that accept deposits or insurance contracts – and so the PRA will oversee banks, building societies, credit unions, insurers and major investment firms. It sets standards and supervises financial institutions at the level of the individual firm.

Objectives

The PRA makes an important contribution to the Bank of England's core purpose of protecting and enhancing the stability of the UK financial system through its two statutory objectives:

- to promote the safety and soundness of systemically important firms.
- (specifically for insurers) to contribute to the securing of an appropriate degree of protection for policyholders.

The PRA is also responsible for "*promot[ing] the safety and soundness of PRA regulated persons*". This is to ensure that PRA authorised persons "*carry on in a way which avoids adverse effect on the stability of the UK financial system*" and that, should a PRA authorised person fail, the impact on the system as a whole is minimised.

Policyholders are protected both by the FCA (who is responsible for ensuring consumers are treated fairly) and the PRA. The PRA's focus is to ensure that "policyholders have an appropriate degree of continuity of cover for the risks they are insured against".

In general terms the PRA's objectives require insurers to be resilient against failure and to be able to avoid disrupting the financial services sector as a whole. Although insurers do not threaten the stability of the financial system in the same way as banks, a failure does have the potential to cause significant disruption. However, despite this threat, the PRA's remit is clear in that it is not there to prevent all failures. If an insurer were to fail, it is the PRA's role to make sure that disruption is kept to a minimum and that there is a degree of continuity of cover for policyholders.

Approach to regulation

The PRA's role is to judge whether insurers are 'safe and sound' – a key aspect of this is meeting the threshold conditions (see below). Its approach to regulation and supervision has three characteristics:

- **A judgement-based approach**: The PRA will use judgement in determining whether financial firms are safe and sound, whether insurers provide appropriate protection for policyholders and whether firms continue to meet the Threshold Conditions.
- **A forward-looking approach**: The PRA will assess firms not just against current risks, but also against those that could plausibly arise in the future. Where the PRA judges it necessary to intervene, it will generally aim to do so at an early stage.
- **A focused approach**: The PRA will focus on those issues and those firms that pose the greatest risk to the stability of the UK financial system and policyholders.

The PRA's approach differs across life, general, wholesale and reinsurance sectors, recognising the differences business models, liabilities and risk exposures.

Threshold Conditions

The 'Threshold Conditions' will be the minimum requirements that firms must meet in order to be permitted to carry on regulated activities. The Threshold Conditions for which the PRA will be responsible are designed to promote safety and soundness (NB The Threshold Conditions for insurers are different to those for banks). At a high level, the draft Threshold Conditions require:

- A firm's head office, and in particular its mind and management, to be in the United Kingdom.
- A firm's business to be conducted in a prudent manner — and that the firm maintains appropriate financial and non-financial resources.
- The firm itself to be fit and proper and be appropriately staffed.
- The firm and its group to be capable of being effectively supervised.
- Firms must ensure that they meet the Threshold Conditions at all times. The PRA will assess firms against them on a continuous basis.

Judgment-led regulation

The PRA's proposed judgment-led approach to supervision will be characterised by a move away from rules and a focus on forward looking analysis including an assessment of how a firm would be resolved if it were to fail, the impact this would have on the system as a whole and the use of public funds. The aim is therefore to "pre-empt risks before they crystalise". Central to the new approach is a new risk assessment framework.

Risk assessment framework

The PRA's new risk framework reflects its additional objective to protect policyholders as well as the financial system. The framework captures three elements:

- **The potential impact** on policyholders and the financial system of a firm coming under stress of failing.
- How the **macroeconomic and business risk** context in which a firm operates might affect the viability of its business model.
- **Mitigating factors**, including risk management, governance, financial position including its solvency position and resolvability.

Figure 3: The PRA's new risk framework

Gross risk			Safety and soundness				
1. Potential impact	2. Risk context		3. Operational mitigation		4. Financial mitigation		5. Structural mitigation
Potential impact	External context	Business risks	Risk management and controls	Management and governance	Liquidity	Capital	Resolvability

The intensity of supervision

The intensity with which firms are supervised depends on their level of riskiness related to the areas above. However, all firms will face at least a '**baseline level of monitoring**'. This involves:

- Ensuring compliance with prudential standards for capital.
- Liquidity, asset valuation, provisioning and reserving.
- At least an annual review of the risks posed by firms or sectors to the PRA's objectives.
- Assessing a firm's planned recovery actions and how it might exit the market.

Proactive Intervention Framework (PIF)

The PRA's judgement about proximity to failure will be captured in a firm's position within the Proactive Intervention Framework (PIF). Such judgements will be derived from those elements of the supervisory assessment framework that reflect the risks faced by a firm and its ability to manage them — namely, external context, business risk, management and governance, risk management and controls, capital and liquidity.

There will be five clearly demarcated PIF stages, each denoting a different proximity to failure, and every firm will sit in a particular stage at each point in time. As a firm moves to a higher PIF stage — i.e. as the PRA determines that the firm's viability has deteriorated — supervisors will review their supervisory actions accordingly. Senior management of firms will be expected to ensure they take appropriate remedial action to reduce the likelihood of failure. And the authorities will ensure appropriate preparedness for resolution.

In focus: firms' culture and prudential supervision

The PRA expects insurers to have a culture that supports their prudent management. Good prudential management must be pursued by all individuals working in an insurance company not just senior staff. But the PRA will have "no right culture in mind" when making judgements about firms.

The PRA will focus instead on "whether boards and management clearly understand the circumstances in which the insurer's solvency and viability come into question, whether accepted orthodoxies are challenged, and whether action is taken to address risks on a timely basis".

The PRA states firms must have:

- Sufficient controls to minimise excessive risk taking.
- Insurers and individuals must behave in an open and cooperative manner.
- An insurer's board must take responsibility for establishing, embedding and maintaining the type of culture described above.

The PRA's supervisory approach suggests that firms will face increased scrutiny the more their organisational culture fails to demonstrate a strong, joined up model to managing the prudential risks related to their business. Supervisors will assess risks using expertise and judgement rather than box-ticking. It is therefore up to firms to show how their organisation is managing prudential risks appropriately – there is no 'one size fits all' approach. If firms fail to do this they could find themselves facing greater intervention from the regulator as they move up the PIF.

The regulation of Lloyd's of London

The PRA will be the lead regulator for Lloyd's as a whole, though the FCA will take responsibility for certain conduct of business issues. The Society of Lloyd's and Lloyd's managing agents will be dual regulated firms; Lloyds members' agents and Lloyd's brokers will be FCA-regulated firms. The Memorandum of Understanding (MoU) between the FCA and the PRA sets out how they co-ordinate in respect of the supervision of the Lloyd's market.

Industry engagement

It has been stated that the PRA will engage with the boards and senior management of firms in forming its decisions, using this dialogue both to ensure that it takes account of all relevant information in reaching its judgments, and to communicate clearly the rationale for them. Firms should not, however, approach their relationship with the PRA as a negotiation.

Coordination

Given the potential for regulatory overlap between the FCA and PRA, the legislation provides a number of general coordination mechanisms:

- A **statutory duty on the PRA and the FCA to coordinate** their activities (including consulting with one another to gather views where necessary).
- An obligation to prepare a **Memorandum of Understanding** (including setting out the role of each regulator and how they are interlinked). The draft MoU between the FCA and the PRA can be found here: http://www.bankofengland.co.uk/about/Documents/mous/moufcapra.pdf
- Cross-membership of boards (see board membership – FCA above, PRA below).
- A **veto mechanism** for the PRA to reduce the risk of regulatory actions threatening financial stability or the disorderly failure of a firm. See below "in focus" box for more details.
- A requirement that the PRA and FCA include in their annual reports an account of **how they have coordinated during the year.**
- The regulators have also set out a **MoU on with-profits** business between the PRA and FCA as outlined above.

In focus: the PRA's veto power

The PRA's power of veto ensures that the new regulatory regime can at certain times of stress prioritise financial stability over consumer protection. According to the Financial Services Act, the PRA can direct the FCA to refrain from particular action if it believes that action might threaten financial stability or result in the failure of a PRA - authorised person.

In "normal times", free of serious economic stress, there is arguably little risk of the veto being invoked. But it is far from certain how it will be used during episodes like the recent financial crisis. Questions remain about when the PRA will decide to invoke this power and what effect this will have on customers.

PRA Board members

The members of the PRA Board, as of April 2013, are:

- Sir Mervyn King, Governor (Mark Carney from May 2013)
- Paul Tucker, Deputy Governor, Prudential Regulation
- Andrew Bailey, Deputy Governor, Financial Stability
- Martin Wheatley, Chief Executive, FCA
- Iain Cornish, independent director
- Rosalind Gilmore, independent director
- Charles Randell, independent director

4. Financial Policy Committee

Chair: Bank of England Governor (Sir Mervyn King until May 2013; then Mark Carney)

Scope and objectives

Run by the Bank of England, the FPC has responsibility for macro-prudential supervision. It is responsible for spotting the systemic risks "attributable to structural features of financial markets or to the distribution of risk within the financial sector". It is also responsible for identifying unsustainable levels of leverage, debt or credit growth.

Having identified the risks, the FPC has the power to take various policy measures to counteract them. Examples of so-called **macro-prudential tools** include:

- **Setting countercyclical capital buffers**: Ensuring that banks increase their capital in the 'good times' so they have protection for the bad. This should also have the affect of tempering lending during a boom and so dampening the effect of the credit cycle.
- **Variable risk weights**: Enforcing targeted capital requirements on specific sectors or asset classes. This could include requiring banks to hold greater levels of capital against asset exposures that represent substantial risk.
- **Leverage Limits**: Limiting excessive build up of on and off balance sheet leverage. Since measures of risk can be unreliable, a leverage ratio could act as a back-stop to risk-weighted requirements (such as a capital buffer).

As well as these financial stability considerations, the FPC will also have a statutory obligation to limit the impact of its policies on economic growth.

To read more about the Bank of England's macro-prudential tools please see the following discussion paper: http://www.bankofengland.co.uk/publications/Documents/other/financialstability/discussionpaper111220.pdf

Governance

The FPC has a total membership of 12, comprising six executives of the Bank of England, and five members from outside the Bank. In addition, the FPC includes a non-voting Treasury member. It is chaired by the Governor, and includes the existing Deputy Governors for monetary policy and financial stability, and the newly created Deputy Governor for prudential regulation.

The Chief Executive of the FCA also sits on the FPC, as do four independent external members, appointed by the Chancellor and recruited in a similar manner to the current external membership of the Monetary Policy Committee.

Members of the FPC (as of April 2013)

- The Governor of the Bank (acting as Chair of Committee) – Sir Mervyn King (Mark Carney from May 2013).
- The Deputy Governors for financial stability and monetary policy – Paul Tucker & Charles Bean.
- The newly created Deputy Governor for prudential regulation (who will also be the Chief Executive of the PRA) – Andrew Bailey.
- Executive Director, financial stability – Andrew Haldane.
- The Chief Executive of the FCA – Martin Wheatley.
- Four independent members appointed by the Chancellor – Dame Clara Furse; Donald Kohn; Richard Sharp; Martin Taylor.
- A non-voting Treasury representative.

The Government has noted the importance of external members having direct market expertise in areas such as insurance. *"The Government and the Bank of England are committed to ensuring an appropriate balance and breadth of expertise for both the interim FPC and the permanent body and will make all efforts to ensure this is the case".*

Accountability

The Treasury is able to provide the FPC with guidance in the form of a remit alongside its statutory objectives, to help shape its pursuit of financial stability. The FPC is required to respond to the Treasury's recommendations, setting out to what extent it agrees with the remit and what action it intends to take in response. However, according to the legislation, the FPC may reject any recommendations from the Treasury which it does not agree with.

The Government has legislated to require the FPC to publish a Financial Stability Report twice a year. The Government requires the FPC to publish a record of each FPC meeting within six weeks. These meeting records describe the FPC's discussions in broad terms, but without identifying the contributions of individual members.

In focus: the world's most powerful central bank

With the Bank of England having independent responsibility for monetary policy, "macro-prudential regulation" and "micro-prudential regulation", many argue that the Governor of the Bank of England will be the world's most powerful central banker.

Not surprisingly, given this level of responsibility, Parliament and the Treasury Select Committee (TSC) in particular have raised their concerns about the level of power vested in a few hands. They have also raised concerns about the accountability of what some argue is a rather antiquated and centralised institution.

Mark Carney will be taking over as the new Governor of the Bank of England with effect from May 2013 (from his previous role as Governor of the Bank of Canada). But serious questions remain about the accountability and transparency of the Central Bank and its ability to take on such significant responsibilities. Expect more political wrangling on this theme in the year ahead even if in broad terms the Bank's future role is now set.

5. European Representation

The legislation touches on how the new regulatory structure will engage with Europe. With regards to representation within the various European bodies the following has been decided:

- The Bank of England sits on the **European Systemic Risk Board**.
- The PRA, as a regulator of banks and insurers, holds the UK seat on both the **European Banking Authority** and the **European Insurance and Occupational Pensions Authority**.
- The FCA represents the UK at the European Securities and Markets Authority.
- The Treasury continues to represent the UK in political-level negotiations on **European directives and regulations.**

In order to ensure a **consistent strategic view** across the different regulatory bodies there is a memorandum of understanding covering:

- The process for discussing and agreeing strategic objectives.
- Which authority represents the UK in each European body.
- How the authorities will coordinate their engagement in international bodies.
- How each authority will consult the others in advance.
- How authorities will seek views from interested parties in advance of meetings.
- The memorandum of understanding on **international organisations** can be accessed from:

http://www.hm-treasury.gov.uk/d/memorandum_of_understanding_international_organisations.pdf

Useful Links

The **Financial Services Act 2012:** http://services.parliament.uk/bills/2012-13/financialservices.html

The **FCA Risk Outlook 2013:** http://www.fsa.gov.uk/static/pubs/other/fcarco.pdf

The **FCA's Business Plan 2013-14:** http://www.fsa.gov.uk/static/pubs/plan/bp2013-14.pdf

The **FCA's supervision of firms:** http://www.fsa.gov.uk/static/pubs/other/factsheet1_fca_supervise_firms.pdf

The **FCA's handbook:** http://fshandbook.info/FS/html/FCA/

The **FCA report on regulatory failure:** http://www.fca.org.uk/your-fca/documents/how-fca-will-investigate-and-report-on-regulatory-failure

The **MoU between FCA & FOS:** http://www.financial-ombudsman.org.uk/about/MOU_with_FCA-APRIL2013.pdf

The **MoU between FCA & PRA:** http://www.bankofengland.co.uk/about/Documents/mous/moufcapra.pdf

The **PRA's approach to insurance regulation:**
http://www.bankofengland.co.uk/publications/Documents/praapproach/insuranceappr1304.pdf

The **PRA's approach to the regulation of deposit taking institutions:**
http://www.bankofengland.co.uk/publications/Documents/praapproach/bankingappr1304.pdf

The **PRA's handbook:** http://www.bankofengland.co.uk/pra/Pages/policy/handbook.aspx

The **Financial Policy Committee:** http://www.bankofengland.co.uk/financialstability/Pages/fpc/default.aspx

CII Briefings

A briefing on the FCA Risk Outlook and Business Plan 2013-14 can be found here:
http://www.cii.co.uk/knowledge/policy-and-public-affairs/articles/cii-briefing-fca-financial-risk-outlook-business-plan-2013/25138

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