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The London Disputes Newsletter

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Who's Regulating the Banks Now?

This article examines the new Financial Services Bill. It goes through certain of the changes to the current regulatory framework, and considers where the impact of the proposed legislation on financial services providers will be felt most.

The new Financial Services Bill was published on 27 January 2012, and represents a significant step in the UK government's overhaul of the regulatory framework of the financial services sector. The Bill's publication follows extensive pre-legislative scrutiny of an earlier draft bill published in June 2011, as well as several previous consultations. The government currently expects to obtain royal assent for the Bill by the end of this year (2012), and the Bill's provisions may begin to take legal effect early in 2013.

This article examines certain of the noteworthy departures from the UK's current regulatory framework, and analyses the potential impact of these changes.

Changes to the Regulatory Structure

The Financial Services Authority (FSA) will cease to exist and three new regulatory bodies will be established:

- The Prudential Regulatory Authority (PRA), a new subsidiary of the Bank of England, which will be responsible for the prudential supervision of over 2,000 firms, of which half will be deposit-takers, and for the oversight and management of systemic risks to the financial markets.
- The Financial Conduct Authority (FCA), which is to oversee regulated firms' conduct. The FCA will replace the UK Listing Authority.
- A new Financial Policy Committee (FPC) within the Bank of England, which is to act as the UK's new macro-prudential regulator.

Both the FCA and PRA are expected to co-ordinate efforts in the discharge of their respective regulatory duties, and a draft memorandum of understanding between both regulators has been published and is awaiting parliamentary approval. In addition, the Treasury has also been granted powers to direct the Bank to take specific actions during periods where there exists a "risk to public funds".

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Noteworthy Departures From the UK's Current Regulatory Regime

- **Supervisory duties**

Regulators' supervisory powers are to be expanded significantly, with the PRA under an express duty to supervise and ensure firms' compliance with the regulatory regime. The PRA's supervisory approach will build on the more intensive approach adopted by the FSA since the financial crisis. According to the body's chief executive designate, Hector Sants, the PRA's purpose is fundamentally different from that of previous regulatory regimes and will lead to a significantly different model of supervision to that which was in use pre-2007. Mr Sants has further noted that the new regulatory model will be based on forward looking judgements and will be underpinned by the fact that the PRA has a single objective to promote the stability of the UK financial system.

- **Holding companies**

More powers have been given to the PRA to issue directions to holding companies of PRA-regulated firms. The PRA will, for instance, have the ability to put in place rules regarding the provision of regular information, as well as having expanded enforcement powers (specifically, censure or fine).

- **Product intervention**

Consistent with previous drafts, the Bill continues to provide for FCA powers to impose certain requirements or an outright ban on financial products that it considers to be problematic. The FCA will also be able to publish details of any warning notices it issues or any particular products or promotions it has banned or characterised as "misleading". A policy statement clarifying the FCA's role in product intervention is to be published in due course, though government statements suggest that it does not envision this power being deployed regularly by the FCA in the exercise of its functions.

- **Strategic objective**

Firm conduct is to be regulated more proactively by the FCA than it has been by the FSA. The FCA's strategic objective has been further expanded to ensuring the relevant markets "function well". Earlier drafts of the Bill had limited the duty to the promotion of confidence in the market.

- **Competition and consumer protection**

Similarly, the FCA's competition and consumer protection mandates have become more robust, with the FCA's operational objective to be focused on "promoting effective competition in the interests of consumers". This objective is accompanied by a list of factors to be promulgated, with a view to providing the FCA with broad powers to intervene and address competition-related issues in the market. When interpreting its new mandate and consumer protection objective, the FCA is explicitly directed to "have regard" to the principle that regulated firms should be expected to exercise an "appropriate" degree of care in any consumer dealings, as well as the need for consumers to be provided with "timely", "accurate" and "fit for purpose" information and advice. Regulation of consumer credit services will also be transferred to the FCA. Further, the consumer complaints process has been streamlined. Specific consumer groups will be given the power to make formal complaints to the FCA, and the FCA is required to investigate and respond within a 90-day period.

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- **Management**

Attempts have been made to increase accountability of senior management within the new regulatory framework. The Bill includes an express requirement that the FCA “have regard” to the role of senior management in ensuring a firm’s compliance with the relevant regulations.

Impact of Changes

In general, the majority of the latest revisions to the Bill have been included with a clear view to buttressing consumer rights and protections in light of concerns about that sector and address general public concerns about the regulation of banks in light of the financial crisis. Of particular concern to in-house counsel will be the continued inclusion of the FCA’s broad interventionist powers in relation to financial products and the increased accountability of senior management. To date, there is an absence of clear guidance on this issue, and the apparent enhancement of regulators’ powers in relation to financial products and promotions may pose significant operational risks to financial services providers. However, the new regulatory framework and rules will inevitably require careful scrutiny of firms’ existing operations to ensure minimum upheaval.

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