

Response by Royal London Group to HM Treasury Consultation Paper:

A New Approach to Financial Regulation – Building a Stronger System

1. About Royal London

Royal London is the UK's largest mutual Life and Pensions Company, with funds under management of £42.2 billion.

Group businesses serve around 3.1 million customers and employ 2790 people.

We help our customers create a secure and safe financial environment for their lives by providing a range of products and services to a broad spread of customers. Royal London is committed to becoming a leading provider of financial services products in the UK. We aim to provide the highest standards of customer service and to develop products and services that are recognised as market leading. Our specialist businesses are clearly positioned in each of their markets. Their goal is to provide adaptable solutions that match the needs of distribution partners and customers.

Figures quoted are as at 31 December 2010.

The Royal London Group's specialist businesses provide pensions, protection and investment products. Products are distributed through intermediaries.

2. Introduction

Royal London is pleased to see that the Consultation contains much greater detail on the workings of the new regulatory architecture than its predecessor. However we do have some strong views on the proposals and these are covered in our General Comments below as well as the detailed answers to the questions.

3. General Comments

Cost of Capital for UK Regulated Firms

We feel that the new approach to financial regulation will inevitably increase costs on regulated firms especially when they are dual regulated by both PRA and FCA. This will have cost implications for the return on capital that can be made in the sector and ultimately the availability of capital. This takes place at a time when a greater proportion of the burden for retirement and protection provision has to be undertaken in the private sector providers. These same providers will need to attract capital and

provide a sufficient return on that capital. The cost of regulation cannot be allowed to price the providers of capital out of UK and other mature EU markets.

Mutual Policy

We cannot believe that Government has rejected “diversity in ownership” as one of the strategic objectives of both PRA and FCA especially as this is a key commitment contained in the Coalition Government agreement of May 2010 (as mentioned in section 3.18). While the other “additional factors” raised as part of the earlier consultation, factors such as “competitiveness” and “public understanding” have been hard-wired in the operation of the regulatory authorities (via OFT and CFEB respectively), “diversity” has been dismissed in a couple of paragraphs (3.18 and 5.54).

We are sceptical that the proposed “level playing field” measures (5.55), specifically the requirement to include analysis of the impacts on mutually-owned institutions as part of the consultation process, will be in any way effective.

In its report on Financial Regulation (January 2011) the Treasury Committee calls into question the operation of the cost benefit analysis under FSA and recommends (paragraph 141) that “cost benefit analysis must be improved under PRA and the [then] CPMA”.¹

We can find no evidence of this recommendation of the Treasury Committee being adopted in the proposals contained in the current Consultation. It is not therefore evident how CBA information will be built up to form an “impartial evidence base” on “whether the legislative framework continues to treat diverse financial business models appropriately.” (5. 55)

We would argue that diversity of ownership models in the financial system is a prerequisite of sustained financial stability. Indeed Andrew Haldane, the Bank of England’s Executive Director of Financial Stability, in a recent speech “Rethinking the Financial Network” argues that the origins of the financial crisis that started in 2007 can be blamed on an absence of diversity in the system².

The Government’s proposals for engineering a “level playing field” for diverse ownership models by retrospective reference to highly-subjective cost-benefit analyses is a wholly inadequate policy response.

We do however take some comfort from Hector Sants recent evidence to the All Party Parliamentary Group for Building Societies and Financial Mutuals. In his oral evidence to the inquiry on 27th January 2011 and in a letter to the Chair of the APPG (dated 17th February) Mr Sants stated “I can confirm that the Prudential Regulation Authority (PRA), which I will lead, aims to have a designated individual

¹ <http://www.publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/430/430i.pdf>

² <http://www.bankofengland.co.uk/publications/speeches/2009/speech386.pdf>

responsible for Building Societies and, as I stated during the session, an individual responsible for the life insurance mutual component”.

Royal London will be pressing to have Mr Sants’s commitment to appoint an individual with oversight for insurance mutuals in PRA written into the forthcoming White Paper and the Bill within it. We will also be seeking an equivalent appointment within the Financial Conduct Authority.

Day-to-day Operation of Regulatory Architecture

There is a very strong case to be made for a single point of contact to be appointed for firms that are regulated by both PRA and FCA. Under the current proposals there is enormous scope for duplication of effort and for miscommunication as both regulatory authorities need to be fully apprised of developments within a regulated firm. A single point of regulatory contact would aid efficient day-to-day communication and dispense with layers of duplicated resource within the authorities.

4. Responses to individual questions from the Consultation

1 What are your views on the likely effectiveness and impact of these instruments as macro-prudential tools?

No comment

2 Are there any other potential macro-prudential tools which you believe the interim FPC and the Government should consider?

No comment

3 Do you have any general comments on the proposed role, governance and accountability mechanisms of the FPC?

In general terms the role, governance and accountability of the FPC seem appropriate.

4 Do you have any comments on the proposals for the regulation of systemically important infrastructure?

Systemically important infrastructure plays a vital role in the efficient operation of markets. It is important that the FCA, in its capacity as markets regulator, has the leading day-to-day role in the regulation of market infrastructure. This needs careful co-ordination with the work of the FPC.

5 What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the PRA?

As we state in the “General Comments” section diversity of ownership has a fundamental part to play in the stability of financial systems. The UK is no exception to this rule. The strategic objective of PRA should include the promotion of diversity.

We agree that insurance companies should be prudentially regulated by PRA despite the complexity that regulation by dual authorities may bring (see “General Comments”).

We are in general agreement to the proposed regulatory principles.

6 What are your views on the scope proposed for the PRA, including Lloyd's, and the allocation mechanism and procedural safeguards for firms conducting the 'dealing in investments as principal' regulated activity?

As stated in the answer to Q.5 Royal London fully support the proposal that PRA should regulate the soundness of insurance companies. It is also right that FCA retains the responsibility for policyholder protection.

However we see a very real tension between the respective responsibilities of the two regulatory authorities and this is alluded to in paragraph 3.22. The PRA's focus on insurance firms maintaining a sound balance sheet is potentially at odds with the FCA responsibilities for consumer protection and optimising policyholder returns. This is especially the case of the management of with profit funds where the expectations of the current generation of policyholders may be in conflict with the insurance company's ongoing capital requirements. Here the PRA and FCA may be seen to be facing in opposite directions.

We assume that the PRA's responsibility to promote confidence in the system would prevail over short-term demands for "windfall" type returns to individual generations of policyholder. We believe that the precedence of the PRA in potential areas of conflict such as this will be reflected in the enabling legislation.

7. What are your views on the mechanisms proposed to make the regulator judgement-led, particularly regarding: rule-making; authorisation; approved persons; and enforcement (including hearing appeals against some decisions on a more limited grounds for appeal)?

In principle we agree that the PRA should adopt a judgement-led approach to regulation, focussing on the significant risks within the sectors it regulates.

However we do not see how this approach to rule-making will fit comfortably with the European Supervisory Authorities and their powers to impose binding technical standards on national regulators. The rules made by PRA (paragraph 3.32) must presumably fit within the existing framework of EU directives and the binding technical standards laid down by the ESAs.

We would look to PRA to employ its judgement-led approach in the exercise of its powers of authorisation, approving individuals as fit and proper and in enforcement.

We look forward to receiving details of and commenting on the proposed Proactive Intervention Framework in due course.

8 What are your views on the proposed governance framework for the PRA and its relationship with the Bank of England?

This section of the CP concentrates on PRA accountability to the Court of Directors of the Bank of England. This may be wholly appropriate but PRA must ensure that individuals are appointed to the PRA Board with the required insurance sector expertise to appreciate the very different prudential risks and associated mitigating actions that arise in the insurance sector.

9 What are your views on the accountability mechanisms proposed for the PRA?

We support the proposals that Treasury ministers retain the right to commission independent reviews into the efficiency and effectiveness of PRA and that the PRA should be audited by NAO with an accountability to the Public Accounts Committee.

The new requirement for the prudential regulator to report to Treasury in the event of a regulatory failure is also to be welcomed.

There is no mention of the current arrangements for the regulator to report regularly to the House of Commons Treasury Committee. This is an important component in the scrutiny of the regulator and should be retained. We believe that when the Treasury Committee makes recommendations for changes in the work of PRA that these should be acted upon or the reason for their non-applicability explained via Ministerial statement.

10 What are your views on the Government's proposed mechanisms for the PRA's engagement with industry and the wider public?

The PRA should be required to consult widely with practitioners (not just the Practitioner Panel) on all changes to rules policies and practices. Given the nature of its regulatory scope, there is no need for PRA to consult with a consumer panel.

The PRA should be alert to emerging legislation from EU institutions. It should not anticipate emerging legislation from the EU (as is currently often the case) but work in concert with legislative developments.

11 What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the FCA?

In line with the comments in the "General Comments" section we believe that FCA should have "facilitating diversity" added to its operational objectives. Objective "a" should read "facilitating efficiency, diversity and choice in the market for financial services".

We are in agreement with the Regulatory Principles and especially welcome clarification over the FCA objectives in the promotion of competition.

12 What are your views on the Government's proposed arrangements for governance and accountability of the FCA?

We are broadly happy with the governance and accountability arrangements for the FCA which reflect many of the best practices of the FSA regime.

13 What are your views on the proposed new FCA product intervention power?

We are not clear what regulatory failures that Government is trying to address by giving FCA new interventionist powers. Most of the perceived problems are already being addressed by initiatives such as the Retail Distribution Review which is yet to come into force.

14 The Government would welcome specific comments on:

- **the proposed approach to the FCA using transparency and disclosure as a regulatory tool;**
- **the proposed new power in relation to financial promotions; and**
- **the proposed new power in relation to warning notices.**

We welcome the proposal that FCA should be open in its thinking on developments in the market. This will help firms to embrace good practice and anticipate the direction of regulatory thinking.

We do not have any problem with the proposed power to allow FCA to require firms to withdraw misleading financial promotions provided this action is not on a name and shame basis and firms have a right to appeal against the order.

We are very strongly against the proposal to grant FCA the powers to publish warning notices that enforcement action against a regulated firm may be about to be taken. This early action seems to circumvent due process and poses huge reputational and commercial risks to firms. What if the proposed enforcement action were to prove groundless? Would regulated firms have an automatic right to redress against the regulator if the early publication of a notice were shown to be inappropriate?

We urge Government to abandon this draconian proposal.

15 Which, if any, of the additional new powers in relation to general competition law outlined above would be appropriate for the FCA? Are there any other powers the Government should consider?

We have no views on the proposals.

16 The Government would welcome specific comments on:

- the proposals for RIEs and Part XVIII of FSMA; and
- the proposals in relation to listing and primary market regulation.

We strongly support the Government's decision to retain the responsibility for the UK Listing Authority within the markets regulator.

17 What are your views on the mechanisms and processes proposed to support effective coordination between the PRA and the FCA?

As stated in the "General Comments" section that where the firm is subject to dual regulation, such as in Royal London's case, that there should be a single point of contact coordinating the flow of communication between regulators and the regulated.

Coordination of effort in this way will improve efficiency and reduce overlap and costs. Wherever possible the PRA and FCA should share processes such as maintaining the register, regulatory approvals / APERS, fee calculation and invoicing.

18 What are your views on the Government's proposal that the PRA should be able to veto an FCA taking actions that would be likely to lead to the disorderly failure of a firm or wider financial instability?

We support the use of a veto in very limited circumstances and note the safeguards that will be built into the process – to notify parliament of the veto in all but carefully circumscribed cases.

We would be surprised to see the veto used in situations where the risks that are being mitigated by proposed FCA action clearly outweigh any prudential issues intended to be addressed by a veto.

19 What are your views on the proposed models for the authorisation process – which do you prefer, and why?

We would prefer to see the alternative proposal examined in more depth. The "lead proposal", involving a dual regulated firm such as the Royal London Group, making separate applications to each regulator would involve potential conflict and duplication of roles, responsibilities and process as well as additional compliance costs. The alternative approach detailed in 5.38 – 5.40 should be examined further with a view to designing an approach that is efficient, whilst at the same time achieving the regulatory objectives of authorisation.

20 What are your views on the proposals on variation and removal of permissions?

We agree that both the PRA and the FCA should have powers to vary permissions, replicating, in effect, the present way of working. However we are concerned that there should be a mechanism in place to address the situation where a unilateral withdrawal of permission by the PRA may have considerable impacts upon the objectives of the FCA in relation to that firm – as per our response to Q18, there may be circumstances in which the achievement of FCA objectives outweighs those of the PRA.

21 What are your views on the Government's proposals for the approved persons regime under the new regulatory architecture?

The proposals seem pragmatic and workable, with clear responsibility for each Controlled Function being allocated to either the PRA or the FCA.

22 What are your views on the Government's proposals on passporting?

Section 5.51 states that the PRA will work closely with the home state regulators of those firms which have branches in the UK to ensure the financial stability of the UK system, even where its own powers are limited in respect of prudential issues. This seems to us somewhat of a dichotomy and will lead to lack of clarity over who is responsible for prudential regulation of such firms. Where the PRA has concerns about a passported in firm what powers will it have to force the home state regulator to take action? We suspect very limited, unless escalated through the relevant ESA.

23 What are your views on the Government's proposals on the treatment of mutual organisations in the new regulatory architecture?

The proposed approach to the treatment of mutual organisations is wholly inadequate. There is no attempt to encourage the growth of mutual organisations or diversity of ownership.

Trying to ensure there is "a level playing field" by reference to historic CBA data is a proposal that does not warrant serious consideration.

See our comment in the General Comments section.

24 What are your views on the process and powers proposed for making and waiving rules?

We support the proposals for each authority to be able to waive its own rules in specific cases at the request of firms. The additional step for the PRA to be consulted where the firm is dual regulated may add delay and cost to the process and the process should be designed in such a way to minimise this impact together with measurable service standards.

25 The Government would welcome specific comments on

- **proposals to support effective group supervision by the new authorities – including the new power of direction; and**
- **proposals to introduce a new power of direction over unregulated parent entities in certain circumstances?**

We have no comments on this section.

26 What are your views on proposals for the new authorities' powers and coordination requirements attached to change of control applications and Part VII transfers?

We support the proposals for the PRA to have responsibility for specific regulatory duties connected with Part VII applications. As the PRA will be required to consult with the FCA on these issues our generic comment relating to the efficiency of such consultation applies.

27 What are your views on the Government's proposals for the new regulatory authorities' powers and roles in insolvency proceedings?

No comment

28 What are your views on the Government's proposals for the new authorities' powers in respect of fees and levies?

We welcome the proposal for a non-statutory arrangement to be put in place for the collection of fees through one organisation, similar to that which currently exists in relation to the collection of the FSCS levy by the FSA.

It seems inevitable that the creation of both the FCA & the PRA will lead to an increase in fees charged to regulated firms. We have substantial concerns that firms will see a large increase in the overall cost of regulation as a result. Many processes are duplicated within the proposals, with both entities being involved in applications for approval, controlled functions, waivers and other regulatory processes. Efficiency in such processes will be critical and duplication must be avoided where possible and sensible.

29 What are your views on the proposed operating model, coordination arrangements and governance for the FSCS?

Royal London supports the view that the FSCS remains a single organisation for administering compensation to consumers and does not have any concerns on the proposed operating model. We do believe and agree that it is vital with each regulator having rule making powers over the FSCS that Memoranda of Understanding are in place from inception and support that MOU's are to be on a statutory footing so that there is full transparency and accountability.

30 What are your views on the proposals relating to the FOS, particularly in relation to transparency?

Royal London supports the proposal for the independent Financial Ombudsman Service to be required to publish an annual plan and to consult on it as appropriate. We firmly believe for the sake of consumer protection that the FOS remains independent of FCA, but understand the need for the two organisations to work closely together. Royal London will welcome in the future further clarification and opportunity to comment on the roles and relationship of the FOS and FCA.

In relation to the proposals on transparency at FOS Royal London has welcomed the initiatives over recent years for providing more guidance to firms on complaint handling, we believe that further can be done and the issue of publishing complaint decisions is a step in this direction. This is an approach that receives our support although with qualification that FOS should be required to consult with stakeholders before issuing policy guidance.

The publication of key decisions illustrating key points is to be welcomed and we fully support this. We do not believe a summary of the decision will be sufficient and believe that the full final decision (not a short form version) will give firms sufficient detail to incorporate the decisions into their own complaint handling when the same issues arise. The decisions should be published with anonymity for all parties.

We do not accept that FOS should be able to rule on cases with "wider implications" for industry participation. This power should reside with the FCA or Upper Tribunal.

31 What are your views on the proposed arrangements for strengthened accountability for the FSCS, FOS and CFEB?

Royal London supports any measure to strengthen accountability and agrees with the proposals for a statutory annual plan and audit by the National Audit Office.

32. What are your views on the proposed arrangements for international coordination outlined above?

It is essential that the UK authorities build influence within the ESAs especially in the area of the setting of binding technical standards. However UK authorities need to be gaining influence not only for their technical expertise but also for their political skill. It is our perception that the UK has lacked political influence in the past and this is not a state of affairs that can be allowed to continue.

It is of course essential that the activities of the UK authorities are coordinated at EU level and internationally. An MoU, as described, is essential for this coordination to be effective.