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## **THE FINANCIAL SERVICES ACT 2010**

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### **Introduction**

They say hindsight is a wonderful thing. Undoubtedly hindsight shows that financial services regulation in the UK failed spectacularly at its first real test. Of course there were also spectacular failures elsewhere in the world, most notably New York. By contrast, however, jurisdictions such as Hong Kong, Singapore and China have performed remarkably well.

Here in the UK, the tripartite authorities set up by the Labour government comprising the Bank of England ("BoE"), the Financial Services Authority ("FSA") and HM Treasury ("HMT"), were completely wrong-footed by the crisis and it took awhile before decisive action was taken to stem the rot. Post mortems have since been carried out into what went wrong, for example, the Turner Review published in March 2009. It became increasingly clear that the FSA and other regulators had suffered "collective intellectual failure" having failed to spot the iceberg before it was too late. The FSA's focus on Principle-based Regulation and related issues such as RDR and TCF had left it hopelessly out on a limb when the crisis broke. You do not hear the FSA chanting these mantras anymore, the talk now is all about "more intensive supervision". It would appear that the FSA is determined to learn the lessons from its past mistakes and this attitude is commendable.

In July 2009, HMT published the Labour government's proposals for regulatory reform which focussed on clarifying the role of the tripartite authorities, consumer protection, higher capital requirements and international issues. A number of HMT's proposals with the notable exception of capital requirements, were contained in the Financial Services Bill announced in the Queen's speech in November 2009.

The Conservative Party, on the other hand, proposed (see The Conservative Party Plan for Sound Banking) a radical change to the UK's regulatory framework including abolishing the FSA and transferring the majority of its powers to the Bank of England. The residual powers will be transferred to a new regulatory body, the Consumer Protection Agency whose focus will be primarily on consumer issues.



## Passing of the Bill

In the run-up to the election on May 6, the Bill was passed after considerable horse trading during the 'wash up' process and on 8 April became the Financial Services Act 2010 ("the Act"). The horse trading resulted in many of the more contentious proposals being dropped. For example, the new Council for Financial Stability to be chaired by the Chancellor. This had been criticised by Baroness Noakes who said "No one should be taken in by dressing up the failed tripartite arrangements in new legislative clothes.." she continued "it fails to identify who is in charge or where the buck stops...." The provisions about FSA's international remit and collective proceedings were also dropped.

Nonetheless, the Act still contains serious additional powers and controls. These include consumer redress schemes and increased powers for the FSA (and in some instances HMT) in relation to living wills, executive remuneration, short selling, information gathering and punishment. The FSA's statutory objectives have also been amended with the addition of "the stability of the UK financial system" and the removal of "promoting public understanding of the financial system." The latter will become the responsibility of a new body, the Consumer Financial Education Body.

## Consumer Redress Scheme

A survivor of the "wash up" process, the Consumer Redress Scheme gives FSA the power to make rules to secure redress where there has been widespread or regular failure resulting in losses to consumers. The FSA will be able to make rules requiring a firm or firms of a specified description to investigate a failure, ascertain the loss or damage and offer appropriate redress to consumers.

## Definition of Consumers

The term "consumers" is widely defined in the Act and not limited to private individuals. It includes anyone who has used, or may have contemplated using, any services as prescribed in the Act as well as those who benefit or suffer indirectly from the service in question. Authorised firms, payment services providers, firms carrying on regulated activities or ancillary activities under MiFID are all within the net of the Consumer Redress Scheme. It should also be noted that HMT has the power to widen the net further. The FSA will require the consent of HMT before it can implement a Consumer Redress Scheme. These new powers can be challenged by reference to the Financial Services Tribunal.



## **Recovery Plans and Living Wills**

Considerably work has been done by the FSA to ensure that the viable parts of a business can be saved so that disruption can be kept to a minimum – the so-called “living wills”. Systemically important banks have been involved in a pilot exercise to produce living wills. The Act empowers the FSA to make rules requiring each bank or each bank of a specified description to prepare and keep up-to-date a living will relating to resolution and recovery (in the event of failure) that would facilitate the business being run by another person.

## **The Problem of Remuneration**

The current FSA remuneration code applies only to about 26 organisations who are large banks, building societies and broker-dealers.

The Act considerably strengthens the FSA’s powers. The FSA will make general rules requiring firms or certain specified firms to have a remuneration policy for their officers, employees and “other persons of a specified description”. In making these new rules, the FSA must take into account the standards published by the Financial Stability Board in September 2009 and other international standards.

In making new rules, the FSA may seek to prohibit remuneration in certain specified ways. The FSA is empowered to provide that an agreement which contravenes any such prohibition may be void and require repayment of monies and benefits. Agreements made prior to the FSA making new rules will not be subject to this prohibition unless any subsequent amendment results in contravening the prohibition. If you are currently negotiating a new agreement, it would be wise to put your skates on.

To cap it all, HMT has the power to require the preparation and disclosure of executives’ remuneration reports. This power potentially has very extensive application as the definition of “executives” is wide.



## **Short Selling Rules**

Previously, the FSA was on rather uncertain ground legally when making short selling rules which were hastily introduced during the financial crisis. The Act specifically empowers the FSA, both in an emergency or longer term basis, to require disclosures of short sales and to gather information on short selling. The continued turmoil in the Eurozone countries, most notably Greece, means that considerable work is still ongoing at the EU and international level. Should the euro implode and rightly or wrongly, the blame is pinned on short selling, it may become an even hotter potato politically.

## **Increased Disciplinary Powers**

The FSA is now empowered to suspend or impose limitations on firm's permissions so that specific business areas can be targeted or a specific firm taken out of the target market.

As stated earlier, the FSA's new intensive supervision means that it wants to demonstrate that it has sharp teeth and for it to be a fearsome regulator. The Act gives the FSA the power to simultaneously impose a penalty and withdraw authorisation. The FSA also is now able to fine any person who is an "unregistered" approved person.

Going forward, the FSA continues its emphasis on more effective regulation. Sally Dewar, FSA's Managing Director of Risk recently said that the FSA will supervise individuals and firms more intensively, and the renewed focus on governance is a clear sign of FSA's intention to strengthen industry practice and ensure that markets and consumers are protected.

Finally, the FSA has a new power to require information from any person (as specified in the Act) where such information is considered to be relevant to the stability of the one or more aspects of the UK financial system.



## **The Next Steps**

Now that the general election is over and the UK has a Conservative-led coalition government, it would seem that the FSA will not, in the immediate future, be abolished although its fate still hangs in the balance. For now there must be sighs of relief all round in Canary Wharf but whether this relief will be permanent will depend on the content of what is in the forthcoming Financial Reform Bill. The Bill is set to bring forward proposals to give the Bank of England control of macro-prudential regulation and oversight of micro-prudential regulation. It is not entirely clear yet what role, if any, the FSA will have. The desirability of splitting banks into “retail” and “casino” banks is to be examined by an independent commission which will report in about a year’s time.

## **Conclusion**

This Act was perhaps the last throw of the dice by a dying government. The FSA does not appear too keen to trumpet its new powers. It is currently consulting on the implementation of the Act.

To a certain extent, all governments spin and that is to be expected. In my view, however, New Labour seems to have gone overboard with spin during its 13 years in office. Let us hope that the new government will be a change for the better. The first signs are encouraging but, of course, only time will tell.

Is this the end of regulatory reform? In the immortal words of Winston Churchill: “Now this is not the end. It is not even the beginning of the end. But it is, perhaps, the end of the beginning.”



## **NOTES FOR EDITORS**

1. Financial Services Compliance (EU) Limited, (“FSC”), is a specialist management consultancy established since 1995 and has won awards for service excellence.
2. The contents of this article are based on information available as at 26 May 2010. This article is intended for information purposes only and should not be relied upon as professional advice.
3. FSC’s clients spread across the entire financial services sector ranging from private equity, stockbroking, investment banking, hedge funds and collective investment schemes both in the UK and overseas.
4. One of FSC’s principal consultants is Clive Briault who is a former Managing Director of FSA.
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