

## **Draft Memorandum of Understanding between the Financial Conduct Authority and Prudential Regulation Authority**

This is the Financial Services Consumer Panel's comments on the draft Memorandum of Understanding (MoU) between the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA).

### **Overview**

The Panel believes this MoU plays a key role in creating a positive, open and collaborative environment in which the PRA and FCA will work. For many consumers, the success of the new twin peaks regulatory structure will be determined by the collective improvements across the financial services industry and not only by how well the PRA manages prudential risks or whether the FCA's actions tackle conduct issues. For this reason, the PRA and FCA should both have an interest in working collaboratively, where appropriate, to help the other regulator deliver their objectives.

The Panel believes there are a number of important areas where the draft MoU can be improved. In particular, we are concerned that the MoU does not clearly outline how the FCA will represent the interests of consumers to the PRA. This is going to be a key role for the FCA given the Financial Services Bill, as currently drafted, does not require the PRA to formally consult the existing Consumer Panel or take guidance from any other consumer groups. We believe the MoU should set out the process by which the FCA will represent the interests of consumers to the PRA, particularly through the development of new policy initiatives.

We also believe the document should adopt a more positive tone that encourages cooperation among all employees of the PRA and FCA, rather than just at CEO and Board level. While both regulators have separate objectives, we believe there is scope to enhance the levels of cooperation through, for example, sharing information.

### **Detailed comments**

#### ***Representing the interests of consumers***

The Panel has long argued that the PRA should be required to consider representations from the Consumer Panel to ensure the impact of their actions on consumers is fully considered. However, the draft Financial Services Bill, as currently worded, does not provide for this. Instead the FCA will represent the interests of consumers to the PRA. Given the importance of this role, we are extremely disappointed that the draft MoU does not cover how the FCA should fulfil this function or how the PRA should seek the FCA's views on issues which may have an impact on consumers.

We consider it essential that the MoU outlines how the FCA will represent the interests of consumers to the PRA, particularly through the development of policy and rule making processes. As part of this, we strongly advocate the MoU setting a requirement for the FCA to consult the Consumer Panel on all issues where they

represent the interests of consumers to the PRA. It is also important to ensure that the MoU does not preclude the PRA from directly seeking the Consumer Panel's input, either formally or informally. We believe the PRA may find the Panel's input helpful in relation to issues which have a direct impact on consumers, such as rules on mortgage forbearance or the Financial Services Compensation Scheme (FSCS).

### ***The nature of the MoU***

The draft MoU starts by outlining that the *'mandates of the PRA and FCA are very different'*. It goes on to state that it is *'vitaly important that this [the difference] is respected'*, while also stating that *'it is essential that the regulators coordinate in some areas and cooperate in others'*. This emphasises the independence of the two organisations. In the light of past experience with the relationship between the Bank of England and the FSA, we suggest it would be more helpful to focus attention on the need to create a framework for effective cooperation that will better protect the interests of consumers and society. To deliver this, the PRA and FCA have different responsibilities, which are reflected through their different objectives, but they will need a framework that will help them to work together where appropriate to enable each other to better fulfil their functions.

### ***Maintaining the MoU***

The Panel supports the intention, as set out in paragraphs 65-67, to regularly review the MoU and require the regulators to assign responsibility for the co-ordination set out in the MoU to a senior executive. However, we believe this could, and should, go further to require the CEOs of the PRA and FCA to set an expectation that there should be cooperation and collaboration with the other regulator at all levels in their organisation. The Panel is concerned that the MoU will mean very little if people at operational levels in both organisations do not meet the expectations it sets out.

### ***Information sharing***

The Panel believes that arrangements to ensure information is shared between the two regulators are fundamental to the success of the new system. However, we are not convinced that the MoU, as currently drafted, creates an expectation of cooperation between the PRA and FCA.

The Panel is concerned that point (ii) in paragraph 14 could prevent either the PRA or FCA from taking efficient and effective action to prevent consumer detriment. We believe it would be more appropriate to allow both regulators to share any information collected from individuals or firms in the course of their duties, but require the information to be maintained in a confidential manner and used only to enable each regulator to deliver their objectives.

In paragraph 10, the draft MoU requires each regulator to offer information where they believe it would be *'of material interest'*. We do not believe this goes far enough. To ensure both regulators are fully aware of the information the other possesses, we believe the MoU should also require a central list of all available information to be maintained. This would provide a mechanism for each regulator to get an idea of what data is available for sharing, rather than simply relying on the other regulator to provide information they feel might be relevant.

In addition, where one regulator consults the other on any issues, we believe the MoU should set an expectation that any relevant information will be shared as part of the consultation process. For example, where one regulator consults the other on a policy they are developing, as required by paragraph 17, the sharing of relevant information should be built into this consultation process.

### ***Consultation on policy and rule making***

The Panel believes it is essential for the PRA and FCA to cooperate and consult each other on major policy initiatives. A good example of FSA reforms which would have required the PRA and FCA to work together is the Mortgage Market Review (MMR). Through the MMR, the FSA is proposing a number of changes to the mortgage market. These reforms are developed not only to enhance consumer protection standards but to *'to ensure the continued provision of mortgage credit for the great majority of borrowers who can afford it, while preventing the re-emergence of the tail of poor lending practice which led to consumer detriment.'*<sup>1</sup> Given the MMR will impact both the macro and micro-economic environment; the prudential position of firms; the conduct of lenders; and ultimately consumers themselves, both the PRA and FCA (and Financial Policy Committee) would have had a strong interest in the reforms. The Panel therefore considers it essential that the MoU clearly sets out an expectation for the two regulators to work together when developing major reform.

Paragraph 17 of the draft MoU requires the PRA and FCA to *'consult each other at an early stage in relation to policy deliberations which might have a material effect on the other's objectives'*. It is unclear what constitutes 'early stage' and we suggest that this should be defined. We believe this consultation should take place before policies are formulated and, where this is not appropriate, sufficiently in advance of publication to allow the other's views to be taken into account.

### ***International cooperation***

We have seen a significant increase in the role of Europe in setting the regulatory framework which applies in the UK. There is also greater cooperation across the globe on issues such as financial stability. It is therefore important that both the PRA and FCA are able to effectively represent the UK's interest in the various international forums in which they participate. For this reason the Panel is separately responding to the MoU on international organisation. However, the Panel feels paragraph 20 of the draft PRA-FCA MoU could better convey the importance of a coordinated and consistent position in Europe. We believe this section should be strengthened by requiring the PRA and FCA to share expertise and exchange staff where appropriate to maximise the UK's impact in shaping international and European policy formation.

### ***Clarifying who has ultimate responsibility for decisions where no agreement can be reached between the PRA and FCA***

We recognise that the MoU is a high level outline of how the PRA and FCA will work together. This will eventually be supplemented by further detailed operational processes. However, we believe it is appropriate to clarify in a number of places

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<sup>1</sup> Lord Turner, Forward to the CP11/31 – Mortgage Market Review: Proposed package of reforms, December 2011.

which organisation would have ultimate responsibility for decisions where no agreement can be reached. This includes key sections of the MoU which cover policy and rule making; conflicts around the supervision of dual regulated firms; formal regulatory processes and enforcement; and co-ordination with other authorities. As a minimum we believe the approach adopted in Annex 1, where the lead regulator is identified for different scenarios, should be used for the main MoU. We also suggest there are significant benefits to establishing a separate forum where differences in opinion could be discussed and debated in detail. We imagine that HMT would be represented on this forum to provide independent input and ensure the Government is aware of the different views of each regulator.

### ***The PRA's right to veto certain FCA regulatory actions***

The Panel believes it is essential that the wording in the MoU to cover the PRA's power to veto is carefully constructed. Any power given to the PRA to overrule the FCA's actions could lead to a suggestion that the FCA is the junior or less important regulator. This could significantly undermine the FCA's ability to deliver its objectives. We therefore believe it is critically important to outline that this power would only be used in exceptional circumstances. We also believe there is merit in providing a non-exhaustive list of potential examples of when this could be used.

In addition, we are concerned that paragraph 64 could allow input from the CEO of the PRA or FCA to be dismissed on the grounds that the issue is '*not relevant to his or her own organisation*'. We believe it would be more appropriate to adopt a positive approach whereby the CEO of each regulator is not required to make input where the issue is not relevant to their organisation, but where any input is provided, this should be considered.

### ***With-profits***

To ensure that the stability of the financial system and rights of with-profit policyholders are adequately protected, the Panel believes it is critically important that provisions for regulating with-profit insurance policies under the new financial regulatory system are clear. The Panel therefore supports the intention to develop a separate PRA-FCA MoU to cover this important area.

The Panel believes it is essential that the with-profits MoU adequately reflects the important role the FCA will play in providing information and advice to the PRA, recognising that the PRA will have ultimate responsibility for the regulation of with-profit business. As a minimum, we believe the with-profits MoU should include the following points:

- a non-exhaustive list of issues on which the PRA is required to seek the advice of the FCA, including, for example, communicating with policyholders;
- a requirement for the FCA to maintain the necessary expertise to ensure it can provide advice and information to the PRA;
- a requirement for the PRA to seek the advice of the FCA before developing proposals or implementing changes in relation to with-profit business;
- a requirement for a specific forum within which the PRA and FCA should discuss issues related to with-profits, for example, quarterly meetings;
- a requirement for responsibility for the exchange of information to be assigned to senior Board members of both the PRA and FCA;

- a requirement for the PRA to take into account the interests of consumers when considering and developing policies, especially in relation to governance and the orderly failure of firms;
- a requirement for the PRA to accept the advice of the FCA unless it believes this would involve a significant risk to the prudential integrity of the insurance industry, reflecting the fact the PRA will rely on the advice of the FCA for non-systemic issues; and
- a requirement for the FCA to have lead responsibility for communicating with-policyholders – this is particularly important as appropriate customer communications is key to enhancing transparency and ensuring consumers are fully informed of their rights.

The Panel also believes the PRA and FCA should undertake joint work to ensure they are fully prepared should there ever be a run on a life insurer. Given the illiquid nature of assets typically held by life insurers, it is essential that both regulators are clear on their individual responsibilities, particularly in relation to issuing clear and timely consumer communications.

16 May 2012