Summary of Current Proposals for the New UK Regulatory Structure

Published by the Broker-Dealer & Investment Management Regulation Group
February 2012

1. Who will be the new regulators?

The regulators will be the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). The PRA will be set up as a subsidiary of The Bank of England, while the FSA will be renamed the FCA. The Financial Policy Committee (FPC) will be set up within The Bank of England.

2. Who will the PRA and FCA regulate?

The PRA will be responsible for the prudential supervision of banks, insurers and major investment firms while the FCA will regulate market conduct and focus on consumer protection. Banks, insurers and major investment firms will have two regulators, while those falling outside these categories will be regulated by the FCA only. It will not regulate firms directly. Of approximately 27,000 regulated firms, approximately 2,000 of these are anticipated to become dual-regulated. The FPC's function includes directing the PRA and FCA to take necessary action regarding macro-issues affecting financial stability.

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3. Who will regulate fund managers?

Major investment firms will potentially include large fund managers. The tests for whether a fund manager is significant enough to be regulated by the PRA are not finalised. In 2011, two separate proposals were made for investment firms that should be considered as significant as follows:

- the government proposed that only BIPRU 730k firms with permissions to deal in investments as principal should be dual-regulated; and
- the FSA proposed that full-scope BIPRU 730k firms with assets >£15billion are significant investments firms.

Most private equity and venture capital fund management firms will therefore not constitute significant investment firms and under these proposals would be regulated by the FCA only. The only current exception may be where the firm has a PRA-regulated entity in the "immediate group"; in such case the PRA and FCA will co ordinate their efforts regarding such a firm.

4. Who will regulate broker/dealers?

If the broker/dealer is a bank, then it will be dual-regulated. If the broker/deal is not a bank, then based on current proposals, it will only be dual-regulated if it is a major investment firm, following the tests outlined in 3. Otherwise it will be regulated by the FCA, unless it has a PRA-regulated entity in the "immediate group", in which case the PRA and FCA will co-ordinate their efforts regarding the broker/dealer.

5. When will the new regulatory structure take effect?

The plan is that the cutover to the new structure will take place early in 2013. The timetable is dependent on the successful passage of the Financial Services Bill through Parliament. The Bill was introduced to Parliament on 26 January 2012.

6. What is the FSA doing to prepare for the new regulatory structure?

Until the Financial Services Bill is passed, the FSA is constrained as to manner in which it may restructure. However, from 2 April 2012 the FSA intends to move, internally, as close as is feasible to the new model, so that cutover to the actual oversight by the PRA and FCA is as smooth as possible.

7. What are the key characteristics of the new regulatory structure?

General principles: A proactive approach to regulation. A judgment-based approach will be taken. Regulators will intervene in businesses if they judge outcomes to be at odds with a firm's mandate, even if the firm does not agree.

Operational: Two supervisory units will run their own ARROW risk mitigation programmes and firms will have two separate sets of mitigating actions to address. The prudential supervisors will introduce a questionnaire focused on ensuring the firm is minimising the risk of disorderly failure. The conduct supervisors will focus on more thematic issues such as business models and product design and whether these identify customers needs.

Behavioral: More intrusive and intensive approach to prudential regulation. Supervisors will not only attempt to ensure standards are met, but will form a view as to whether standards will be met in the future. Conduct regulation will be focused on whether the firm's judgments and business model deliver good outcomes to customers.

8. What are the next steps?

The FSA shall restructure itself internally, as referred to above. The FSA and The Bank of England will publish, later in 2012, two further documents explaining in more detail how the PRA and FCA will function. Some matters that will be addressed are:

> the operating platform that supports the new regulatory model;

> the replacement of ARROW framework with a new "proactive intervention framework" for PRA and a "firm systematic framework" for FCA;

> the detailed procedures of PRA and FCA co-ordination;

> the rule book splitting responsibilities of PRA and FCA; and

> putting in place appropriate staff.

9. What are the roles of the PRA and FCA vis-à-vis the new European Supervisory Authorities?

In a speech on 6 February 2012, Hector Sants, the Chief Executive of the FSA, acknowledged that, currently in respect of prudential regulation, and increasingly in future in respect of conduct, the rules will be made by the European Supervisory Authorities and the roles of PRA and FCA will primarily be one of supervision and enforcement.

10. What should clients be doing to prepare for the new regulatory structure?

Most clients should already have been contacted by the FSA as to whether they will be a dual-regulated firm or will be regulated by the FCA only. Clients should prepare for the more intrusive approach of the FSA and in particular senior management should be able to demonstrate a thorough understanding of its systems and controls and that they are effective to manage the risks of their business. The detailed effects of the new structure on the rule books is not yet known, but clients should be encouraged to participate in any consultation process. If clients that would otherwise be FCA-regulated and who have a PRA- regulated affiliate (e.g. a bank) in the "immediate group" are concerned about the additional influence of the PRA, they may wish to consider a reorganisation to remove themselves from the "immediate group".

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