

Financial Regulation Strategy
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

(by e-mail to financial.reform@hmtreasury.gsi.gov.uk)

12 September 2011

Dear Sirs,

HMT consultation cm8083: “A new approach to financial regulation: the blueprint for reform”

The International Capital Market Association (“ICMA”) is responding to HM Treasury’s above consultation.

ICMA is a unique self regulatory organisation and an influential voice for the global capital market. It represents a broad range of capital market interests including global investment banks and smaller regional banks, as well as asset managers, exchanges, central banks, law firms and other professional advisers. ICMA’s market conventions and standards have been the pillars of the international debt market for over 40 years. See: www.icmagroup.org.

ICMA is responding in relation to its primary market constituency that lead-manages syndicated bond issues throughout Europe. This constituency deliberates principally through ICMA’s Primary Market Practices Sub-committee¹, which gathers the heads and senior members of the syndicate desks of 25 ICMA member banks, and ICMA’s Legal and Documentation Sub-committee², which gathers the heads and senior members of the legal transaction management teams of 19 ICMA member banks, in each case active in lead-managing syndicated bond issues in Europe.

We set out our response in the Annex to this letter and would be pleased to discuss them with you at your convenience.

Yours faithfully,



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¹ <http://www.icmagroup.org/About-ICMA/ICMAs-Committees/Primary-Market-Practices-Sub-committee.aspx>.

² <http://www.icmagroup.org/About-ICMA/ICMAs-Committees/Legal-and-Documentation-Sub-committee.aspx>.

Annex

This response follows prior submissions to preceding consultations in October 2010, December 2010 and April 2011 in this area³. The response focuses on the impact of the proposals on the primary securities markets. We anticipate other constituencies will have responded on other concerns.

We understand and support the overall change in regulatory policy from “light touch” to a more “hands on” model. However, we remain concerned:

- that the existence of a retail investor in a chain that is otherwise wholesale may result in more “retail style” regulation of the wholesale transactions
- that the FCA’s single set of strategic objective and operational objectives could, in theory at least, lead to a uniform application of regulatory tools to all aspects of its work. We believe that this would be damaging to the international markets that are hosted by the UK and that it needs to be made clear that the way in which the regulatory toolkit will be applied, say, in relation to prospectus approval and admission to the regulated market will be markedly different from the way in which it will be applied, say, in relation to the direct sale of products to retail investors
- that, even if these issues are resolved at the level of the FCA, it is unclear whether the FPC will be able to alter the result in pursuit of its own statutory objectives.

1. Wholesale/retail distribution chains

Each of the February and the June consultations refers to distribution chains involving an issuer at one end, a retail investor at the other, and a number of financial intermediaries in the middle. For example, the February paper says, in paragraph 1.39, that “the Government . . . recognises that there are wholesale and markets activities which do not directly form part of the transaction chain of products and services sold to retail customers” and goes on to say that such activities are regulated in a proportionate way (which we presume means less onerous regulation, because non-retail investors are better able to look after their own interests). We agree with this. But the implication is that any chain that does directly involve a retail customer should be more strictly regulated.

This implication is made more explicit in paragraph 4.2 which says that “in regulating wholesale markets and market activities undertaken between professional counterparties, a more nuanced regulatory approach will be appropriate. However, in regulating wholesale markets, the regulator must also be mindful of the links that exist, through the transaction chain, between retail products and services and wholesale market activity”. The FSA’s paper of June 2011 (“The Financial Conduct Authority – Approach to Regulation”) makes a similar point, in paragraph 3.9, “the duty to protect retail consumers will necessitate a focus not only on firms’ conduct towards them directly, but also on the knock-on effects and adverse implications that may result from activities in retail related wholesale markets”. It then goes on, in paragraph 4.7, to say that its activities “could include reaching up the distribution chain, where appropriate, to intervene in wholesale activity where this could be the source of significant retail detriment”.

These comments in the consultation papers take on added significance in the light of the new powers that will be given under the proposed legislation allowing the FCA to make product intervention rules. These are contained in new sections 137C and 137D of FSMA (Clause 19 of the draft Bill), and will allow the FCA to prohibit the entry into specified agreements by authorised persons, either at all or unless they contain certain provisions. The powers also permit the FCA to prevent authorised persons from causing others to enter into certain agreements (or to require that such agreements contain certain provisions. So, the power will exist to prevent the issue of certain bonds by authorised persons or to require that they contain certain provisions.

Some colour has been added as to how these powers will be used by various comments by officials at the FSA about the intention to intervene in the product cycle at a much earlier stage

³ See respectively: <http://www.icmagroup.org/ICMAGroup/files/7f7f7b4aa-3b11-400a-b3f7-5b923654453d.pdf>, <http://www.icmagroup.org/ICMAGroup/files/32/32e5bf61-e17e-4c44-a34d-3025d4a48dc8.pdf> and <http://www.icmagroup.org/ICMAGroup/files/65/65ae180c-c464-4047-aaf5-5c353a3f96a2.pdf>.

and to adopt a more intrusive approach to regulation (most recently Hector Sants' 29 June speech "The Future of Banking Regulation in the UK"⁴). The FSA's Discussion Paper DP 11/1 ("Product Intervention") also heightens concerns by, for example, saying (in paragraph 2.11) that the design of product features will have a major impact on outcomes for the customer (and implying therefore that regulation should address itself to the contractual terms of the product as much as to controlling the terms on which it is sold).

We do not believe that it is right to regulate distribution chains in this way. The EU regulatory framework provides regulatory tools that would allow the FCA to protect retail consumers by taking regulatory action at the point of distribution directly to them – for example, under the know your customer and suitability/appropriateness duties of MiFID. The FCA should make sure that regulation at that level works (for example, by ensuring that the authorised persons who sell products to, or advise, retail investors) are fit for the purpose and that compensation arrangements for mis-selling are adequate. It would be wrong to argue that, because it may be difficult to achieve adequate protection at that level, the regulator should "reach up" into the wholesale links in the chain and try to control there what it has failed to control lower down the chain.

2. Application of regulatory tools to different aspects of FCA's responsibilities

As noted above, it is proposed that there will be a single set of strategic and supporting objectives that applies to the whole range of the FCA's activities and a regulatory toolbox that is designed to enable the FCA to achieve these objectives (including new powers that allow the FCA to judge products and intervene in their design). What is lacking, however, is clarity as to how the tools will, in pursuit of those common objectives, be applied in practice to the various areas of the FCA's responsibilities, which include approval of prospectuses and admission to the regulated markets and regulation of market conduct. In the absence of such clarity, there may be a tendency to apply some regulatory tools to some activities of the FCA in ways that are damaging to the markets.

It would be theoretically possible, for example, for the FCA to intervene in the design of a structured bond to be issued by an authorised person, such as a UK bank. It may argue that the bond in question, if sold to a retail investor, would be inappropriate or unduly risk and therefore, in order to protect the potential retail consumer (as it is bound by statute to do), the product should be redesigned or even banned. But should the regulatory intervention be at the level of the sale to the retail investor (so that it cannot be sold or needs modification before it can be sold)? Or could the FCA, as listing authority, "reach up the chain" and prevent damage at its source by requiring redesign of the product before issue (or even banning its creation)? Proposed new section 137C would appear to give it the power to this.

ICMA believes that the listing and prospectus approval aspects of the FCA's role should focus mainly on disclosure and that product intervention should (except in extreme cases where the product is clearly of no benefit to any investor) form no part of its regulatory toolkit. Provided the prospectus makes appropriate disclosure, it should be possible for an authorised person to issue whatever bond it thinks investors may want to buy, and to have a prospectus for that bond approved and (where required) passported by the FCA and (again, where required) to have the bond admitted to the UK's regulated market. This seems to us to be important because:

- (a) it allows maximum choice of products to market participants. There may be products that are dangerous or otherwise unsuitable for some elements of the market. But there will be few products that are unsuitable for all investors. Some sophisticated investors may require highly structured products involving considerable risk and they may need these to be admitted to the regulated market for a variety of reasons (such as internally or externally imposed investment restrictions). They should not be deprived of their opportunity of buying such products because they might be unsuitable for others. The way to protect retail investors against unsuitable products is not, therefore, to bar such products from the market but to control their sale to retail investors through regulation of the distributors (for example, under the MiFID regime);

⁴ See http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2011/0629_hs.shtml.

- (b) it is more consistent with current law and regulation, particularly that coming from the EU. It is difficult to see, for example, how the FCA could do anything other than admit to the regulated market a product that is the subject of a passported prospectus;
- (c) it would be anomalous to prevent the issue of a particular product by an authorised person when non-authorised persons (who will be outside the product intervention regime) will not be so prevented.

Clarification is needed in order to give the UK's capital markets, which of course are international in nature, the certainty that they need. This could be given either by inserting appropriate language into the legislation or, perhaps, by suitable declaration of intent by the FCA. The FSA's June paper, referred to above, makes a useful start in giving this clarification by saying, in paragraph 5.17 that (in relation to its role as regulator of markets) the FCA "will mainly be concerned with ensuring the integrity and efficiency of markets, ensuring adequate disclosure of information and providing a level playing field for market participants". But this needs much greater detail.

3. Interaction between the FPC and the FCA

A further area of concern relates to the possible interaction of powers given to the FPC and those given to the FCA. Even if clarification as to how the FCA will apply its regulatory tools to its different roles is given, there will still be uncertainty in the mind of the market if the FPC can use its powers to override the FCA and (for example) require that the FCA should ban certain products from admission to UK markets. Again, it may be important to clarify this aspect of the new structure, either in the legislation or by a suitable declaration.