



House of Commons
Regulatory Reform Committee

**Proposal for the
Regulatory Reform
(Financial Services and
Markets Act 2000)
Order 2007**

Third Report of Session 2006–07

*Report, together with formal minutes and
written evidence*

*Ordered by The House of Commons
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The Regulatory Reform Committee

The Regulatory Reform Committee is appointed under Standing Order No. 141 to consider and report to the House of Commons on proposals for regulatory reform orders under the Regulatory Reform Act 2001 and, subsequently, any ensuing draft regulatory reform order. It will also consider any "subordinate provisions order" made under the same Act.

Current membership

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Criteria against which the Committee considers each proposal

Paragraph (6) of Standing Order No.141 requires us to consider any proposal for a regulatory reform order against the following criteria:

... whether the proposal—

- (a) appears to make an inappropriate use of delegated legislation;
- (b) removes or reduces a burden or the authorisation or requirement of a burden;
- (c) continues any necessary protection;
- (d) has been the subject of, and takes appropriate account of, adequate consultation;
- (e) imposes a charge on the public revenues or contains provisions requiring payments to be made to the Exchequer or any government department or to any local or public authority in consideration of any licence or consent or of any services to be rendered, or prescribes the amount of any such charge or payment;
- (f) purports to have retrospective effect;
- (g) gives rise to doubts whether it is *intra vires*;
- (h) requires elucidation, is not written in plain English or appears to be defectively drafted;
- (i) appears to be incompatible with any obligation resulting from membership of the European Union;
- (j) prevents any person from continuing to exercise any right or freedom which he might reasonably expect to continue to exercise;
- (k) satisfies the conditions of proportionality between burdens and benefits set out in sections 1 and 3 of the Regulatory Reform Act 2001;
- (l) satisfies the test of desirability set out in section 3(2)(b) of the 2001 Act;
- (m) has been the subject of, and takes appropriate account of, estimates of increases or reductions in costs or other benefits which may result from its implementation; or
- (n) includes provisions to be designated in the draft order as subordinate provisions.

Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at www.parliament.uk/regrefcom. A list of Reports of the Committee in the present Session of Parliament is at the back of this volume.

Committee staff

The current staff of the Committee are Mick Hillyard (Clerk), Stuart Deacon (Committee Specialist) and Liz Booth (Secretary/Committee Assistant). Assistance was also provided for this report by Sarah Thatcher (Scrutiny Unit).

All correspondence should be addressed to the Clerk of the Regulatory Reform Committee, Delegated Legislation Office, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 2837; the Committee's email address is regrefcom@parliament.uk.

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Summary

Overall recommendation

We have examined the proposal for the Regulatory Reform (Financial Services and Markets Act 2000) Order 2007 (the “draft Order”) in accordance with Standing Order No. 141. We recommend unanimously that a draft Order in the form of the proposal should be laid before the House.

Outline of the proposed Order

The Financial Services and Markets Act 2000 implemented a new regime for the regulation of financial services and markets, including the establishment of the Financial Services Authority as the sole, independent regulator. In 2003/4, HM Treasury undertook a two year review of the new regime, as a result of which a number of areas in need of reform were identified. The purpose of the proposed Order presented pursuant to the Regulatory Reform Act 2001 (RRA) is to reform wholesale and retail financial markets as part of a ten-point action plan of reforms set out in the Government’s Pre-Budget Report 2005. The Government intends that the proposed Order will deal with a series of burdens and restrictions contained in the Financial Services and Markets Act 2000, resulting in a more streamlined approach to regulation.

The proposal for the draft Regulatory Reform (Financial Services and Markets Act 2000) Order was laid before the House by HM Treasury on 18 December 2006. We have considered the proposal against the criteria set out in paragraph (6) of Standing Order No. 141 and report the following conclusions to the House.

Criterion (a): appropriate for delegated legislation

In our view the proposal appears to be appropriate for delegated legislation.

Criterion (b): removal or reduction of burdens

The proposal would remove or reduce a number of burdens.

Criterion (c): maintenance of necessary protection

We are satisfied that no necessary protection would be lost.

Criterion (d): adequate consultation

We consider the proposal has been the subject of, and appropriate account has been taken of, an adequate degree of consultation.

Criterion (e): charges on public revenues, payments to the Exchequer or any public authority

The proposal would not impose any requirements of this kind.

Criterion (f): retrospective effect

The proposal would not have retrospective effect.

Criterion (g): vires of the proposal

The proposal gives rise to no doubts as to whether it is intra vires.

Criterion (h): requires elucidation, is not written in plain English or appears to be defectively drafted

We do not consider the proposal gives rise to any concerns of this kind.

Criterion (i): compatibility with membership of the European Union

We have seen no reason to consider that the proposal is incompatible with obligations arising from membership of the European Union.

Criterion (j): prevention of the exercise of rights and freedoms it would be reasonable to expect to continue

We consider that the proposal would not prevent the exercise of any right or freedom that any person could reasonably expect to continue to enjoy.

Criterion (k): new and re-enacted burdens are proportionate to the benefit which arises from them

We consider the new burdens imposed by the proposal would be proportionate to the beneficial effects which would arise from them.

Criterion (l): extent to which the Order removes burdens or has other beneficial effects makes it desirable for it to be made

We consider the proposal meets the test of desirability in its removal and reduction of burdens.

Criterion (m): estimates of increases or reductions in costs or other benefits and the account taken of them

We consider the Department has made reasonable efforts to foresee the costs, savings and other benefits that could arise from the proposal.

Criterion (n): subordinate provisions

The proposal contains no provisions which are designated as subordinate provisions.

Explanatory Report

Introduction

1. The proposal for the Order was laid before the House by HM Treasury on 18 December 2006.

2. The Financial Services and Markets Act 2000 (FSMA) established a single regulatory framework for financial services and markets. The Financial Services Authority (FSA) was established as the sole, independent regulator and supervisor of the financial sector. The FSMA confers broad regulatory powers on the FSA, but also provides that the FSA is bound by certain duties, must meet defined regulatory objectives and must have regard to statutory principles set out in the FSMA when discharging its general functions.

3. HM Treasury undertook a two-year review of the new FSMA regime in 2003/4, as a result of which various concerns of the financial services industry emerged, including complaints about unnecessary burdens placed on the industry by the FSA and concerns about restrictions on the FSA's use of waivers and modifications to rules. The Economic Secretary to the Treasury ("the Minister") states that this proposed Order forms part of a ten-point action plan of reforms to wholesale and retail financial markets set out in the Government's Pre-Budget Report 2005.¹

4. The proposed Order would remove or reduce burdens in the following areas:

- authorisation requirements in relation to partnerships whose members change [Article 3]
- unnecessary consultation between the FSA and regulators in other countries in the European Economic Area [Article 4]
- obligations on the FSA to fulfil a number of procedural requirements associated with discontinuing or suspending the listing of a security [Article 5-7 and 11]
- requirement on the FSA to issue a warning notice in cases where the cancellation of a sponsor's approval has been requested by the sponsor himself [Article 8]
- the FSA's powers to waive or modify any (as opposed to some) of its rules in respect of authorised and unauthorised persons [Article 9]
- obligations of the FSA when consulting on guidance [Article 1] and
- power of the FSA board to delegate the issuing of guidance [Article 12]

¹ Minister's Statement, paragraphs 7-8

The Committee's remit

5. The House has instructed us to examine the proposal against the criteria specified in Standing Order No. 141(6) and then, in the light of that examination, to report whether the Government should proceed, whether amendments should be made, or whether the Order should not be made.

6. Our discussion of matters arising from our examination is set out below. Where a criterion specified in Standing Order No. 141(6) is not discussed in the report, this indicates that we have had no concerns to raise about that criterion. In the course of our examination, we requested further information from HM Treasury about a number of issues relating to the proposal and the text of our questions to HM Treasury is reproduced in Annex A to this report. HM Treasury's response is reproduced as Annex B.

1 Assessment of the proposal against the Standing Order No. 141(6) criteria

Inappropriate use of delegated legislation [SO No 141(6)(a)]

7. **The proposal appears to be appropriate for delegated legislation.**

Proposals in relation to burdens

8. **As noted above, the proposed Order reduces or removes seven burdens. The analysis below will take each proposal in turn.**

Authorisation requirements: partnerships [section 32 of the FSMA]

Removal, reduction, authorisation or requirement of a burden [SO No 141(6)(b)]

9. The first proposal relates to the situation where a partnership or unincorporated association, which is authorised by the FSA to carry on regulated activities, is dissolved and another firm succeeds to its business. Under section 32 of the FSMA, the authorisation continues to have effect in relation to the successor firm only where:

- i. the members of the successor firm are substantially the same as those of the dissolved firm; and
- ii. the succession is to the whole, or substantially the whole, of the business of the predecessor firm.²

10. Following the first consultation³, in which there was no proposal relating to partnerships, the FSA suggested that s32 be amended on the basis that it causes hardship in certain cases. For example, where one partner of a two-partner firm leaves, in order to carry on the business, s32 requires that the remaining partner must temporarily cease trading and reapply for authorisation, either for himself as sole trader or for the firm with newly-appointed partners, on the basis that the membership of the firm does not remain “substantially the same”.⁴ The Minister states that the current position under s32 of the FSMA constitutes a burden.⁵

11. The second consultation document accordingly set out proposals to amend s32 of the FSMA, effectively returning to the situation which obtained before the FSMA came into force.⁶ Five responses to this proposal were received, all of which were positive.⁷ Under the proposed Order:

- s32(2) would be amended to make clear that an individual, as well as a firm, succeeding to the business of a dissolved firm would benefit from continuing authorisation;
- s32(3) would be amended so that the sole criterion for this continuing authorisation is that the individual or firm succeeds to the whole or substantially the whole of the business of the dissolved firm. The requirement that the members of the successor firm be substantially the same as the dissolved firm would be deleted.

12. The Minister summarises the reasons for seeking to remove the burden by stating that “unnecessary costs of securing reauthorisation from the FSA would be avoided, as would the costs associated with disruption to the business in question”.⁸

13. We consider that the effect of Article 3 of the proposed Order would be to remove a burden as described.

Maintenance of necessary protection [SO No 141(6)(c)]

14. Whilst the current requirement to seek reauthorisation does provide a trigger to reconsider whether the threshold conditions for authorisation are fulfilled, the Minister does not consider that this is a necessary protection.⁹ This is because authorised persons must satisfy the threshold conditions on an ongoing basis and the FSA’s rules provide for other triggers for reconsidering whether the conditions are being met. These triggers

3 A first consultation document on the proposal was published by HM Treasury in December 2005. The consultation period ran from 5 December 2005 until 5 March 2006. In the light of the 34 responses to the first consultation document, the Treasury amended its proposals and issued a second consultation on 24 May 2006, which closed on 21 June 2006.

4 Minister’s Statement, paragraphs 115-116

5 Minister’s Statement, paragraph 24

6 Minister’s Statement, paragraph 117

7 Minister’s Statement, paragraph 118

8 Minister’s Statement, paragraph 27

9 Minister’s Statement, paragraph 30

include notice of a change of partners and a continuing requirement that the firm disclose to the FSA anything of which the FSA would reasonably require notice.¹⁰

15. In response to a question from us, HM Treasury has clarified that, where it is a Limited Liability Partnership (LLP) which succeeds to the business of a partnership or unincorporated association, the proposed amendment will not apply. The structure of an LLP has wide-ranging implications for the way in which a business is carried on and the LLP will, accordingly, be required to make an application for a change of legal status in order to obtain permission to carry on regulated activities.¹¹

16. We consider that the existing reauthorisation requirement does not constitute a necessary protection, given the continuing existence of other triggers with greater relevance to situations which might give rise to causes for concern.

Continuation of reasonable rights and freedoms [SO No 141(6)(j)]

17. No rights or freedoms are affected.

FSA consultation with EEA regulators [section 49(2) of the FSMA]

Removal, reduction, authorisation or requirement of a burden [SO No 141(6)(b)]

18. Section 49(2) of the FSMA requires that the FSA consult with the home state regulator of a European Economic Area (EEA) firm before granting, cancelling or varying a permission to carry out a regulated activity to a person connected with that firm. According to the Treasury, this over-implements the requirements of various EC Directives,¹² which require consultation with other European regulators when a permission is granted or extended, but not when it is cancelled or its scope narrowed.¹³

19. The terms of the first consultation proposed that the FSA would be required to consult EEA regulators where a permission was to be granted or extended, but would no longer be required to consult where the permission was to be cancelled or narrowed. Some respondents argued that this still went beyond the minimum obligations required by the various EC Directives and that this was costly to industry.¹⁴

20. The Treasury therefore amended the proposal for the second consultation, which proposed amending s49(2) so that the FSA would not be required to consult EEA regulators where a permission was either cancelled or varied, which would include variations both narrowing and extending a permission. Notification to EEA regulators in

10 Minister's Statement, paragraph 30

11 Annex B, Q2(a) & (b)

12 Article 12 Banking Consolidation Directive 2000/12/EC; Article 6 Investment Services Directive 93/22/EC; Article 5b(3) UCITS Directive 85/611/EC; all amended by Conglomerates Directive 2002/87; Article 12a First Non-Life Assurance Directive (73/239/EEC) as inserted by the Conglomerates Directive (2002/87/EC)

13 Minister's Statement, paragraph 120

14 Minister's Statement, paragraph 122-123

these circumstances would be left to the FSA's discretion.¹⁵ Further reflection led the Treasury to the view that the EC Directives do require the FSA to consult EEA regulators where a permission is varied to extend into an area of business covered by a different EC Directive to that relevant to the original permission. This point was made in the second consultation document.¹⁶

21. Following a positive response from respondents to the second consultation,¹⁷ the proposed Order amends s49(2) according to the scheme outlined in the second consultation. The FSA would be required to consult EEA regulators only when a permission is being granted or when an existing permission is being varied to extend into an area of business covered by an EC Directive different from that in the existing permission.

22. The Minister considers that over-implementation of the requirements of the various EC Directives is an unnecessary burden. This is particularly so in cases where major financial groups apply for cancellation or variation of permissions which may give rise to consultation with regulators in many different home states in relation to the same permission.¹⁸ Moreover, the Minister claims that the FSA has suffered damage to its reputation through being required by the current s49(2) to consult in circumstances not covered by EC Directives. EEA regulators have complained about such consultations and have confirmed that they themselves are not required to consult home state regulators when cancelling or varying authorisation of a connected person.¹⁹ **We agree that section 49(2) of the FSMA constitutes a burden on the FSA as described above and the effect of the proposal would be to remove it.**

Maintenance of necessary protection [SO No 141(6)(c)]

23. Although the requirements of s49(2) function as protections, the provisions go beyond what is required by various EC Directives and the Minister considers that these are not necessary protections.²⁰ **Although provisions of EC Directives are not determinative of whether or not a protection is necessary, we agree that Article 4 of the proposed Order removes no necessary protections from consumers of financial services.**

Continuation of reasonable rights and freedoms [SO No 141(6)(j)]

24. **Since the proposed amendments will bring the consultation requirements under s49(2) in line with the requirements of EC Directives, we consider that HM Treasury is justified in arguing that the proposed amendments do not affect the exercise of any reasonable rights or freedoms.**²¹

15 Minister's Statement, paragraph 124

16 Regulatory Reform Order: A second consultation on proposed changes to the Financial Services and Markets Act 2000, May 2006, para 5.10

17 Minister's Statement, paragraphs 126-127

18 Minister's Statement, paragraph 38

19 Minister's Statement, paragraph 39

20 Minister's Statement, paragraph 43

21 Minister's Statement, paragraph 44

Simplifying de-listing procedures [sections 77 & 78 of the FSMA]

Removal, reduction, authorisation or requirement of a burden [SO No 141(6)(b)]

25. A listing of securities may be discontinued or suspended either on the initiative of the FSA (s77(1) and (2)) or on the application of the issuer of those securities. The current regime does not, however, make specific provision for the latter, so that the safeguarding provisions intended to protect the interests of the issuer apply whether or not the issuer itself is requesting the discontinuance or suspension of the listing. These safeguards provide that:

- The FSA must give written notice to the issuer of discontinuance or suspension (s78(2)) and the notice must fulfil certain criteria, including reasons for the decision (s78(3)).
- The issuer may make representations to the FSA within a specified period (s78(3)(c) and s78(4)).
- Having considered the representations, the FSA must give the issuer written notice either of its decision to maintain the discontinuance or suspension (s78(5)) or of its decision to restore the listing or refrain from de-listing (s78(8)).
- The issuer may then refer the matter to the Tribunal (s77(5); s78(5), (6) and (7)).
- If the FSA proposes to refuse an application by the issuer for a cancellation or suspension of listing, it must give the issuer a warning notice (s78(10)), following which the issuer has the right to make representations (s78(11)).
- Following consideration of the representations, the FSA must give the issuer written notice of its decision either way (s78(11)). If the application is refused, the issuer may refer the matter to the Tribunal (s78(12)).

26. The principle that the de-listing procedures should be simplified where de-listing was at the request of the issuer was accepted by respondents to both the first and second consultations.²² In cases where the issuer is requesting the discontinuance or suspension of listing, the Minister considers that the current procedures constitute a burden²³ which it is reasonable to reduce by replacing these procedural requirements with less onerous ones tailored to the specific circumstances. **We agree.**

27. The Minister states that the proposed Order would also remove an anomaly (s1(1)(d) RRA) found in s77(5) of FSMA which gives the issuer the right to refer a discontinuance or suspension of listing of securities to the Tribunal in circumstances where that discontinuance or suspension was made at the request of the issuer itself.²⁴ **We agree that the effect of s77(5) in relation to the situation where the issuer is requesting the**

22 Minister's Statement, paragraphs 130-131

23 Minister's Statement, paragraph 51

24 Minister's Statement, paragraph 53

discontinuance or suspension of a listing is anomalous and the anomaly might safely be removed.

28. Under the proposed Order, the s78 procedures, outlined in paragraph 25, would remain in cases where a decision to discontinue or suspend listing is made by the FSA on its own initiative. Where, however, the issuer is requesting the discontinuance or suspension of listing, the proposed Order would introduce a separate set of procedures in a new section 78A.

29. This new section would have the effect of removing the following procedural requirements:

- the obligation for the FSA to give reasons (s78(3)(b));
- the right of the issuer to make representations (s78(3)(c)); and
- the right of the issuer to refer the matter to the Tribunal (s78(3)(e)).

We agree that this constitutes the removal of a burden.

30. On the other hand, new procedural requirements would be introduced where an issuer applies to the FSA for a discontinuance or suspension of the listing of securities:

- the right of the issuer to apply for a discontinuance or suspension (s78A(1));
- the obligation on the FSA to issue a warning notice if it intends to refuse such application (s78A(4));
- the right of the issuer to make representations in response to the warning notice (s78A(5));
- the obligation on the FSA to issue a decision notice if it decides, following representations, to refuse the application (s78A(5));
- the right of the issuer to refer to the Tribunal the FSA's decision to refuse the application for discontinuance or suspension (s78A(6)).

31. There would be further, new procedural requirements where listing has been suspended on the application of the issuer and the issuer then makes a second application to have that suspension cancelled:

- the right of the issuer to apply for cancellation of the suspension (s78A(7));
- the obligation on the FSA to issue a warning notice if it intends to refuse such application (s78A(7));
- the right of the issuer to make representations in response to the warning notice (s78A(8));
- the obligation on the FSA to issue a decision notice if it decides, following representations, to refuse the application or, alternatively, a written notice if it decides to grant the application (s78A(8));

- the right of the issuer to refer to the Tribunal the FSA's decision to refuse the application for cancellation of the suspension (s78A(9)).

The test of proportionality [SO No 141(6)(k)]

32. The Minister states that these proposed provisions amount to new burdens for the purposes of s6(2)(c) of the RRA.²⁵ Nevertheless, the Minister is satisfied that these new burdens would satisfy the test of proportionality (s1(1)(c) RRA). **We agree.**

Maintenance of necessary protection [SO No 141(6)(c)]

33. The Minister states that the proposed new procedural requirements will ensure the maintenance of necessary protections: the FSA will be required to give notice of the details of the discontinuance or suspension; and, where an issuer's request is refused, the FSA must give notice of that refusal, the issuer may make representations and may ultimately refer the matter to the Tribunal.²⁶ To the extent that it is proposed to withdraw certain procedural requirements, the Minister considers that these cannot be characterised as 'necessary protections' in the context of an issuer requesting discontinuance or suspension of a listing of securities.²⁷ **We agree.**

Continuation of reasonable rights and freedoms [SO No 141(6)(j)]

34. There will be no recourse to a tribunal on the part of an issuer of securities in relation to a discontinuance or suspension of a listing in circumstances where the issuer itself has requested such discontinuance or suspension. Since this will have happened by consent of the issuer and the FSA, the Minister does not consider that a reasonable right or freedom will have been withdrawn. Moreover, the issuer will have a new right of recourse to the Tribunal where the FSA refuses its request to discontinue or suspend a listing.²⁸ **We agree that no reasonable right or freedom has been withdrawn.**

Cancelling sponsor approval [section 88 of the FSMA]

Removal, reduction, authorisation or requirement of a burden [SO No 141(6)(b)]

35. A sponsor is a person approved by the FSA to perform services on behalf of others for the purposes of the listing rules.²⁹ Sub-section 88(4) of the FSMA requires the FSA to give the sponsor a warning notice of cancellation of his approval as sponsor. The sponsor then has the right to make representations in response to this warning notice, which the FSA

25 Minister's Statement, paragraph 52

26 Minister's Statement, paragraph 54

27 Minister's Statement, paragraph 54

28 Minister's Statement, paragraph 55

29 s88(1) FSMA

must consider before issuing a decision notice³⁰ from which the sponsor may appeal to the Tribunal.³¹

36. Where the cancellation of approval is made at the request of the sponsor himself, this procedure performs no useful function. The market is informed via the FSA website and the sponsor has no need for notice of a decision he himself requested. The Minister therefore considers that this constitutes a burden on the FSA which serves no useful purpose.³² Respondents to the first and second consultations agreed.³³ **We also agree.**

37. The proposed Order would remove the requirement for the FSA to issue a warning notice in circumstances where the sponsor has requested cancellation of his FSA approval. Since all the other procedural requirements (representations, decision notices, recourse to the Tribunal) are contingent on the warning notice, they do not arise if the FSA is exempt from issuing the warning notice in the first place. **We agree that this constitutes removal of a burden which otherwise serves no useful purpose.**

38. The Minister characterises the requirement for a warning notice and attendant procedural requirements where cancellation of approval is at the request of the sponsor as inconsistent with analogous procedures in sections 54 and 298, relating to cancellation of a firm's Part IV permission and de-recognition respectively. These procedures do not operate where cancellation of the permission or de-recognition is at the request of the person concerned.³⁴ The Minister considers, therefore, that the requirement of s88(4) of the FSMA is inconsistent and disproportionate.³⁵ **We agree.**

Maintenance of necessary protection [SO No 141(6)(c)]

39. The Minister does not consider that any necessary protections are being removed since the sponsor is himself applying for cancellation of his FSA approval. **We agree.**

40. We sought assurances from HM Treasury that, in the absence of any specific proposals in the proposed Order about announcements to the market, the market would receive clear and up to date information about approved sponsors. HM Treasury has replied that the FSA currently maintains a list of approved sponsors on its website which is updated to reflect the removal of any sponsors from the list.³⁶ In addition, HM Treasury states that the FSA is currently considering the best approach to communication to the market of cancellation of sponsor approval and will consult publicly on this issue in due course.³⁷ **We are satisfied that this is not a matter which necessarily needs to be enshrined in primary legislation as long as the FSA's approach is subject to appropriate public consultation by the FSA.**

30 s88(5) and (6) FSMA

31 s88(7) FSMA

32 Minister's Statement, paragraph 61

33 Minister's Statement, paragraphs 138 and 140

34 Minister's Statement, paragraph 62

35 Minister's Statement, paragraph 62

36 Annex B, Q5

37 Annex B, Q5

Continuation of reasonable rights and freedoms [SO No 141(6)(j)]

41. The proposed Order will deny access to the Tribunal only in cases where the sponsor is himself requesting cancellation of FSA approval. The Minister therefore considers that no reasonable rights and freedoms will be affected.³⁸ **We agree.**

Removing restrictions on waivers and modifications [section 148 of the FSMA]

Removal, reduction, authorisation or requirement of a burden [SO No 141(6)(b)]

42. The FSA may only waive or modify the rules listed in s148(1) of the FSMA. Moreover, waiver or modification of rules is only allowed on the application or with the consent of ‘authorised persons’.³⁹ The effect of this is that there are some rules in respect of which the FSA is currently unable to issue a waiver or modification (ie those not on the list in s148(1)) and no waiver or modification is available in relation to unauthorised persons, even though they may be also be subject to FSA rules. The Minister considers it anomalous that the FSA is unable to grant a waiver or modification to all those subject to its rules.⁴⁰

43. We consider it to be a burden that there are persons subject to FSA rules who are not able to benefit from the FSMA’s waiver and modification provisions. Equally, we agree that it is anomalous that the FSA is unable to grant a waiver or modification in respect of all its rules and to all those subject to its rules.

44. The proposed Order will amend s148 so that the FSA will be able to waive or modify all of its rules so long as they are satisfied that:

- compliance would otherwise be unduly burdensome or would not achieve the purpose for which the rules were made;⁴¹ and
- the waiver or modification would not result in undue risk to persons whose interests the rules are intended to protect.⁴²

45. The remainder of the section would be amended so that its provisions apply to any person subject to FSA rules, removing the current restriction to authorised persons only.

46. We conclude that this will remove the burden and the anomaly so that the FSA will be able to waive or modify all of its rules; and all those subject to those rules will also be subject to the FSMA’s waiver and modification provisions.

38 Minister’s Statement, paragraph 66

39 s148(2) FSMA

40 Minister’s Statement, paragraph 71

41 s148(4)(a) FSMA

42 s148(4)(b) FSMA

Maintenance of necessary protection [SO No 141(6)(c)]

47. No necessary protection will be removed.

Continuation of reasonable rights and freedoms [SO No 141(6)(j)]

48. No person will be prevented from exercising any reasonable rights and freedoms.

Lighter consultation on guidance [section 157 of the FSMA]***Removal, reduction, authorisation or requirement of a burden [SO No 141(6)(b)]***

49. Under s155 of the FSMA, the FSA must consult publicly when issuing guidance. Section 157(3) of the FSMA requires the FSA to do certain things, including producing the following:

- a cost benefit analysis (s155(2)(a));
- an explanation of the purpose of the proposed guidance on its rules (s155(2)(b));
- an explanation of the FSA's reasons for believing that making the proposed guidance is compatible with the FSA's general duties (s155(2)(c));
- an account of representations made (s155(5)); and
- a note detailing how the final guidance differs from the initial draft (s155(6)).⁴³

50. The Minister considers that these requirements are overly burdensome, particularly since they apply equally to unwritten and temporary guidance.⁴⁴ There is an exemption available under s155(7) of the FSMA under which the FSA is excused compliance with the consultation requirements where it considers that the delay involved in complying with them would be prejudicial to the interests of consumers. There is no further exemption. The Minister states that this causes two problems: prejudicial delay to others who are not consumers, including firms and others subject to guidance; and consultation for no useful purpose where the scope of the changes to the rules is minor and the level of consultation is accordingly disproportionate.⁴⁵

51. The first consultation proposed two options: one narrow, one broad. The narrow option effectively proposed extending the scope of the current exemption so that the FSA would be excused the consultation requirements where it considers that the delay involved would be prejudicial to the interests of anyone affected by it (not just consumers) and

43 Minister's Statement, paragraph 83

44 Minister's Statement, paragraph 164

45 Minister's Statement, paragraphs 85, 163 and 164; Second Consultation, para 3.2

where the FSA considers that the changes would have minor effect.⁴⁶ The Treasury also proposed to remove the requirement to consult on temporary and unwritten guidance.⁴⁷

52. The broad option was an additional proposal which would involve removing from the FSA the requirements, when consulting on guidance, to produce a cost benefit analysis (s155(2)(a)); a statement of compatibility with the FSA’s statutory duties (s155(2)(c)); an account of representations made during the consultation (s155(5)); and a note detailing how the final guidance differs from the draft circulated for consultation (s155(6)).⁴⁸ The Minister characterises this as a “lighter touch” regime.⁴⁹

53. The first consultation received a mixed response, with some concern expressed in relation to the exercise of FSA discretion on what amounts to ‘minor effect’ under the narrow option and the opportunity for public scrutiny and representations in respect of changes in guidance.⁵⁰ Respondents highlighted the fact that firms treat compliance with guidance almost as seriously as compliance with rules, an approach which is likely to continue as rules become more principle-based.⁵¹ The FSA and the Government have countered that guidance is not binding and has no ‘evidential’ effect in terms of whether or not a person has complied with the rules.⁵² Guidance is intended to “throw light on a particular aspect of regulatory requirements”.⁵³

54. Another view is that, in the modern compliance climate, it might be thought necessary for prudence’s sake to take very serious thought before ignoring any guidance issued by a rule-making body on the application of rules which have the force of law, notwithstanding that such guidance is not itself legally binding. Compliance officers may feel obliged to err on the side of caution and consider that they cannot themselves determine with safety which guidance to follow and which to ignore. We put this view to HM Treasury and asked for some illustrative examples to cast more light on this issue.⁵⁴ The response was full and helpful, essentially maintaining the position that guidance is indicative, not binding, and that a person may achieve compliance without necessarily following guidance. In addition, HM Treasury states that, although it would expect a tribunal to be made aware of any guidance relating to the relevant rules, the tribunal is at liberty to depart from the FSA’s construction of those rules.⁵⁵ HM Treasury quotes the FSA’s proposed Enforcement Guide which states that “The relevance and appropriate weight to attach to guidance will depend on all the circumstances of the case, including the nature of the firm’s defence. It is for the decision maker ... to determine this on a case-by-case basis”.⁵⁶ While we do not take issue with HM Treasury’s presentation of the legal position and its practical effects, we observe

46 Minister’s Statement, paragraph 165

47 Minister’s Statement, paragraph 168

48 Minister’s Statement, paragraph 170

49 Minister’s Statement, paragraph 171

50 Minister’s Statement, paragraph 172

51 Minister’s Statement, paragraph 173

52 Minister’s Statement, paragraph 190

53 Minister’s Statement, paragraph 191

54 Annex A, Q8(a), (b) & (c)

55 Annex B, Q8(a), (b) & (c)

56 Annex B, Q8(b)

that, the situation here described, inherent in an environment where guidance of uncertain import is offered by a regulator on rules having the force of law, may lead compliance officers to adhere strictly to guidance which does not itself have binding force, simply to avoid the risks of uncertainty.

55. Following the first consultation, HM Treasury detected what it terms ‘a consensus’ of industry views and, accordingly, rejected the narrow option in advance of the second consultation. Rejection was on the basis that the FSMA already allows for a ‘lighter-touch consultation process’, including in relation to minor changes.⁵⁷

56. The broad option, together with the proposal to remove temporary and unwritten guidance from the consultation regime, was taken forward into the second consultation.⁵⁸

57. While most respondents were supportive of a more flexible approach to guidance,⁵⁹ there was limited concern over the issue of exempting unwritten guidance from the consultation regime, since this could have the same status as written guidance.⁶⁰ Following discussion with the FSA, the Treasury has decided not to exempt temporary and unwritten guidance.⁶¹ Much unwritten guidance would not, in any event, come within the scope of the existing consultation regime.

58. Following the second consultation, the broad option has been adopted and the proposal to remove temporary and unwritten guidance from the consultation regime has been rejected. The proposed Order would amend section 157(3) to remove the requirements set out in paragraph 49 above. It would remain open to the FSA to produce such information should it consider it appropriate, but it would no longer be compelled to do so.⁶² The FSA would be required to publish its draft guidance publicly and to receive and take account of representations. The Minister considers that this will remove a burden from the FSA and allow it to issue guidance in a more flexible, speedy and less costly manner. **We agree.**

Maintenance of necessary protection [SO No 141(6)(c)]

59. The Minister states that no necessary protections are being removed since the FSA is still required to bring proposed guidance to public attention and to take account of any representations received.⁶³

60. Notwithstanding our comments about the relative status of rules and guidance, highlighted in paragraph 54 above, we consider that the remaining obligations on the FSA – to publish guidance, to receive and to take account of representations – are sufficient to safeguard the interests of those affected by the guidance.

57 Minister’s Statement, paragraphs 178, 184 and 186; Second Consultation, paragraph 3.19; Annex B, Q9

58 Minister’s Statement, paragraphs 179 and 180

59 Minister’s Statement, paragraph 182

60 Minister’s Statement, paragraph 183

61 Minister’s Statement, paragraphs 184 and 185

62 Minister’s Statement, paragraph 84

63 Minister’s Statement, paragraph 88

Continuation of reasonable rights and freedoms [SO No 141(6)(j)]

61. **Given the remaining requirements that the FSA publish guidance publicly and that the FSA must receive and take account of representations, we consider that the proposals will not prevent the exercise of any reasonable rights or freedoms.**

Delegating the issue of guidance [Sch 1, para 5 of the FSMA]

Removal, reduction, authorisation or requirement of a burden [SO No 141(6)(b)]

62. Schedule 1, paragraph 5(2) currently requires that the FSA must exercise its duty to issue guidance through its governing body. The Minister considers that this requirement is a burden since the governing body spends time and other resources considering routine or technical guidance.⁶⁴ **We agree.**

63. The proposed Order would permit delegation of the task of issuing general guidance to a committee or sub-committee of the board of the FSA. The Minister states that this would reduce the burden on the governing body, enable more timely and responsive issuing of guidance which should, in turn, lead to reduced compliance costs. Although not required in the primary legislation, the FSA may issue a policy statement explaining the operation of the new arrangements and, in particular, how consistency, quality and publication of guidelines is to be assured. The statement may also explain membership of the committee or sub-committee and its accountability to the board.⁶⁵ We have asked for, and received, assurances from HM Treasury that such a policy statement will be made by the FSA.⁶⁶

64. **We agree that the current requirements constitute a burden which would be reduced by the proposal to allow delegation of guidance by the governing body.**

Maintenance of necessary protection [SO No 141(6)(c)]

65. The Minister reasserts the Government's position that "the status and nature of FSA guidance is such that it does not have the force of legislation but simply provides assistance with the mode of implementation of rules" and, accordingly, the Government does not consider that the approval of such guidance by the governing body constitutes a 'necessary protection'. The Government considers that guidance issued by a committee or sub-committee would still be subject to internal checks and balances but would benefit from not being hampered with the more onerous procedures involved in attaining approval from the governing body.⁶⁷

66. **Subject to the assurances about a policy statement from the FSA detailed in paragraph 63 above, in particular in relation to statements of policy concerning sufficient checks and balances on the actions of any committee or sub-committee of the**

64 Minister's Statement, paragraph 96

65 Minister's Statement, paragraph 97

66 Annex A, Q10; Annex B, Q10

67 Minister's Statement, paragraph 100

FSA board, we consider that no necessary protection will have been removed. We expect the Government to communicate to the FSA the importance we attach to this policy statement and its contents and encourage the Government to monitor closely the progress of the FSA in relation to its formulation.

Fair balance and desirability

67. Where a proposed Order creates a new burden, we are required to assess whether the Order as a whole satisfies the tests of fair balance and desirability (s3(2) RRA). As noted above, the proposed Order would introduce new procedural requirements where an issuer applies to the FSA for a discontinuance or suspension of the listing of securities. We have already commented on the proportionality of this burden. We conclude that, taken as whole, the Order strikes a fair balance between the public interest and the interests of the persons affected by the burden created and is desirable on the basis that it removes or reduces other burdens.

Adequate consultation [SO No 141(6)(d)]

68. A first consultation document on the proposal was published by HM Treasury in December 2005. The consultation period ran from 5 December 2005 until 5 March 2006. The consultation document was made available to the public on the Treasury website and was sent to various organisations connected with the financial services industry.⁶⁸

69. In the light of the 34 responses to the first consultation document, the Treasury amended its proposals and issued a second consultation on 24 May 2006, which closed on 21 June 2006. The Minister states that the shorter deadline was “in line with Cabinet Office advice as the Government had already consulted on the bulk of the proposal”.⁶⁹ This second consultation covered a new proposal received during the first consultation, together with changes to the initial proposals. It was published on the Treasury website and sent to all those who responded to the first consultation. Twelve responses to the second consultation were received.⁷⁰

70. The consultation was also referred to the Welsh Assembly (pursuant to s5(1) of the Regulatory Reform Act), the Scottish Executive and the Office of the First Minister and Deputy First Minister for Northern Ireland. No comments were received.⁷¹

71. Paragraphs 110-218 of the Statement set out key points made by respondents to the first and second consultations and gives the Treasury’s responses to these points.

72. We consider that the proposal has been the subject of adequate consultation and that the Government has taken appropriate account of the responses received.

68 Regulatory Reform Order: a consultation on proposed changes to the Financial Services and Markets Act 2000, p51

69 Minister’s Statement, paragraph 111

70 Minister’s Statement, paragraphs 110-112

71 Minister’s Statement, paragraph 113

Estimates of costs, savings and other benefits [SO No 141(6)(m)]

73. The Treasury has addressed the economic, environmental and social implications of the proposal at pages 11-14 of the Final Regulatory Impact Assessment (“the RIA”) and has included a tabulated summary at pages 15-19.

74. This information is also discussed in relation to each separate proposal in the Minister’s Statement in the section entitled “Information required by section 6(2) of the Regulatory Reform Act 2001”.

75. The Minister states that some of the cost savings and benefits of more flexible FSA rule application are difficult to quantify. Nevertheless, if the proposals are implemented, he estimates total administrative savings for firms at between £7.5 and £9.3 million and the total administrative savings for the FSA at between £54,175 and £118,250 per annum.⁷²

76. Some of the proposals would give rise to benefits other than cost savings, such as removing administrative inconvenience and swifter production of more coherent FSA guidance.⁷³

77. Having regard to the information contained in the Minister’s Statement and the RIA, we consider that the Minister has made reasonable efforts to foresee the costs, savings and other benefits which could arise from the proposal.

Compatibility with obligations arising from membership of the European Union [SO No 141(6)(i)]

78. The Minister has stated in his Statement that the provisions of the proposed Order are compatible with EU obligations and the European Convention on Human Rights.⁷⁴ His Statement notes that the major question mark in this area arises in relation to the proposal to withdraw a right to refer a de-listing of securities to the Tribunal (the proposed amendments to ss77 and 78 FSMA). However, this is only proposed in cases where the applicant has himself requested the de-listing, so that there is no sense in him making an application to the Tribunal on this point. He loses nothing valuable as a result of the proposal to withdraw that right. On the other hand, the proposal provides for new rights of recourse to the Tribunal in circumstances where an applicant’s request for de-listing is refused by the FSA.

79. The Minister does not consider that the proposals to reduce consultation with EEA regulators contravenes any EU obligation because the consultation requirements are only being reduced to the extent that they over-implement EC Directives.

72 Minister’s Statement, paragraph 20; RIA para A.99

73 Minister’s Statement, paragraph 22

74 Minister’s Statement, paragraphs 219-226

2 Conclusion

80. We conclude that a draft Order in the same form as the proposal should be laid before the House.

Formal minutes

Tuesday 13 March 2007

Members present:

Dr Doug Naysmith, in the Chair

Lorely Burt
Alison Seabeck

Ms Angela C Smith

The Committee deliberated.

Draft Report [Proposal for the Regulatory Reform (Financial Services and Markets Act 2000) Order 2007], proposed by the Chairman, brought up and read.

Ordered, That the Chairman's draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 80 read and agreed to.

Resolved, That the Report be the Third Report of the Committee to the House.

Ordered, That the Chairman do make the Report to the House.

Several papers were ordered to be appended to the Report.

Ordered, That the Appendices to the Report be reported to the House.

[Adjourned till a day and time to be fixed by the Chairman.]

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Appendix A

Letter from the Clerk of the Committee to HM Treasury

Proposal for the Regulatory Reform (Financial Services and Markets Act 2000) Order 2007

Thank you for the presentation which you made yesterday with your colleagues on the subject of the Treasury's RRO proposals for reform of the Financial Services and Markets Act 2000 (FSMA).

The Committee considered the proposal and decided to seek further information from you on a number of points. The issues which concern the Committee are set out below, together with an indication of the relevant provisions of the FSMA and the Committee's Standing Order.

Authorisation requirements: partnerships [section 32 of the FSMA]

Whether the proposal removes or reduces a burden or the authorisation or requirement of a burden (S.O. 141 (6)(b))

1. The effect of the proposed amendments to s32 is relatively clear: whether the successor to the business is an individual or a firm with a significantly changed membership, FSA authorisation of the successor entity will continue as long as it succeeds to the whole, or substantially the whole, of the business of the predecessor firm.

2. However, paragraph 26 of the Minister's Statement is ambiguous and seems to suggest that the requirement to cease trading and reapply for authorisation will only be removed where one of the partners leaves the business and where a sole practitioner will be carrying on the business.

Q1. Please indicate whether it is the Government's intention that the successor firm will continue to have FSA authorisation to carry on the whole, or substantially the whole, of a business, regardless of changes in membership of the firm and regardless of whether the successor is a firm or a sole trader.

Q2. (a) What is the current position under FSMA in relation to limited liability partnerships?

(b) Does the Treasury consider that it would be sensible to deal in this RRO with the issue of authorisation of LLPs succeeding to the business of a dissolved firm?

FSA consultation with EEA regulators [section 49(2) of the FSMA]

Whether the proposal requires elucidation, is not written in plain English or appears to be defectively drafted (S.O. 141 (6)(h)); whether the proposal appears to be incompatible with any obligation resulting from membership of the European Union; (S.O. 141 (6)(i))

3. The Government's position is that the provisions of s49(2) of the FSMA over-implement the requirements of various EC Directives by requiring consultation with EEA regulators before a permission is granted, varied or cancelled. The proposed Order will require consultation only before a permission is granted or before a permission is varied to allow activity covered by a different EC Directive to that in the original permission. It is proposed that other variations and cancellations will not give rise to a requirement to consult.

4. The Minister's Statement references Article 39 of the Consolidated Life Assurance Directive, which we believe should be properly referenced as 2002/83/EC. Article 39 requires the competent authority of the home Member State to notify the competent authorities of the other Member States in the event of the withdrawal or lapse of the authorisation of a life assurance undertaking. This appears to amount to notification after the event in order to prevent rogue trading across the EU, rather than consultation prior to a decision.

Q3. (a) If the Treasury is of the view that this notification does not constitute consultation within the meaning of s49(2) of the FSMA, please confirm that Article 39 of the Consolidated Life Assurance Directive is irrelevant for the purposes of s49(2).

(b) Alternatively, if the Treasury considers that notification pursuant to Article 39 does fall within the meaning of consultation under s49(2) of the FSMA, please indicate how the Treasury intends to incorporate notification in relation to a withdrawal or lapse of authorisation into the proposed scheme for amending s49(2).

Cancelling sponsor approval [section 88 of the FSMA]

Whether the proposal continues any necessary protection (S.O. 141 (6)(c)); whether the proposal prevents any person from continuing to exercise any reasonable right or freedom (S.O. 141 (6)(j))

5. The Government proposes amendments to s88 of the FSMA in relation to the procedures to be adopted where a sponsor himself requests that his FSA approval be cancelled. The issues are similar to those in relation to delisting of securities at the request of the issuer. In the latter case, the issuer has recourse to the Tribunal if the FSA refuses to grant its request for delisting. On the other hand, there is no proposed provision for recourse to the Tribunal if the FSA refuses the request of a sponsor for his approval to be cancelled.

Q4. Please explain the justification for not granting a right to sponsors to petition the Tribunal in cases where their request for cancellation of approval is refused by the FSA.

6. The Minister's Statement does not characterise as a necessary protection announcements to the market that a sponsor's approval has been cancelled. Clearly, it is important that the market should have up to date information about approved sponsors. One respondent to the consultation suggested that the market should be informed by a clear statement on the FSA website and that the sponsor should be informed of the cancellation of its approval.

Q5. What assurances can the Treasury provide that, in the absence of any proposals in the RRO about announcements to the market, the market will receive clear and up to date information about approved sponsors?

Removing restrictions on waivers and modifications [section 148 of the FSMA]

Whether the proposal removes or reduces a burden or the authorisation or requirement of a burden (S.O. 141 (6)(b))

7. The proposed Order will amend s148 so that the FSA will be able to waive or modify all of its rules, subject to certain conditions.

Q6. Will such waiver or modification apply to a class of persons, or only to individuals? Please provide examples to illustrate your answer.

Q7. To the extent that a rule is being modified, how will the FSA decide the appropriate level of modification of that rule? Please provide examples to illustrate your answer.

Lighter consultation on guidance [section 157 of the FSMA]

Whether the proposal has been the subject of, and takes appropriate account of, adequate consultation (S.O. 141 (6)(d)); whether the proposal requires elucidation, is not written in plain English or appears to be defectively drafted (S.O. 141 (6)(h))

8. Respondents to the proposals about lighter consultation on guidance have raised concerns that firms tend to treat compliance with guidance on the rules almost as seriously as compliance with the rules themselves, an approach which is likely to continue as rules become more principle-based. The Government counters that the guidance is not binding and has no ‘evidential’ effect in terms of whether or not a person has complied with the rules: guidance is merely intended to throw light on the rules.

9. Whilst the FSA issues guidance on many different issues, the proposals in relation to s157 of the FSMA relate specifically to guidance *on the rules*. It is by no means obvious that, in the modern compliance climate, guidance on the rules is likely to be treated as having much less force than the rules themselves, particularly when it is the rule-making body issuing that guidance. On the assumption that compliance officers cannot easily pick and choose which guidance to follow and which they may safely ignore, it would be reasonable to consider guidance to be indicative of the way in which the rules are likely to be interpreted by the FSA.

Q8. (a) Please explain with reference to the text of the FSMA the legal status which the Treasury considers applies to guidance issued by the FSA acting under powers given in s. 157(1)?

(b) On what basis does the Treasury claim that a Tribunal or court would not use the guidance as at least indicative of the way in which the rules should be applied, given that that guidance is issued by the rule-making body?

(c) Please provide some examples to illustrate the Treasury’s responses.

10. The Minister’s Statement states that s157(3) of the FSMA already allows for a ‘lighter-touch consultation process’, including in relation to minor changes. Yet the Minister’s Statement also makes the case for lighter-touch consultation on guidance on the basis that full consultation is currently required in relation to minor changes.

11. It is clear that s157(3) requires consultation only on guidance addressed to “regulated persons generally” or to a “class of regulated persons”. It is also clear that there is a limited exception to the requirement to consult on guidance derived from s155(7). However, these provisions relate only to whether the FSA is required to consult or not, they do not relate to the level of consultation required.

Q9. Please explain how s157(3) currently allows for a lighter-touch consultation process.

Delegating the issue of guidance [Sch 1, para 5 of the FSMA]

Whether the proposal continues any necessary protection (S.O. 141 (6)(c))

12. The proposed Order would allow delegation of the issuing of guidance to a committee or sub-committee. The Treasury has stated that the FSA would issue a policy statement explaining the operation of the new arrangements and, in particular, how consistency, quality and publication of guidelines is to be assured. The statement would also explain membership of the committee or sub-committee and how it would be held accountable. Clearly, this would be an important document.

Q10. What assurances can the Treasury give that the FSA will issue a policy statement dealing with these issues?

In providing your answers, please bear in mind that the Committee will require an explanation of the points of principle raised by each question. However, given that the issues are in many cases quite technical, it would

be helpful if you could provide examples to illustrate the points of principle. These may assist the Committee in understanding the scope and application of the proposals.

I should be grateful to receive your response to these questions, together with any additional information which the Department believes would be helpful to the Committee, not later than 19 February 2007.

8 February 2007

Appendix B

Letter from HM Treasury to the Clerk of the Committee

Proposal for the Regulatory Reform (Financial Services and Markets Act 2000) Order 2007: response to request for information

Thank you for your letter dated 8 February setting out the issues on which the Committee would like further information. I will take each questions in the order in which it was presented in your letter.

Authorisation requirements: partnerships [section 32 of the FSMA]

Q1. Please indicate whether it is the Government's intention that the successor firm will continue to have FSA authorisation to carry on the whole, or substantially the whole, of a business, regardless of changes in membership of the firm and regardless of whether the successor is a firm or a sole trader.

Yes, this is the case. Not only does the existing law causing difficulties in relation to a partnership that has two partners and one of the partners leaves the partnership, similar problems apply where the business of the partnership remains largely unchanged but the members of the partnership change substantially, including if the partnership expands. The proposed amendment seeks to return to the situation that existed prior to FSMA.

Q2. (a) What is the current position under FSMA in relation to limited liability partnerships?

Permission to carry on a regulated activity is granted to specified persons. Section 40 of FSMA sets out a list of persons who may make an application for permission, these are: an individual, a body corporate, a partnership and an unincorporated association. Although sections 44 to 46 provide for a permission to be varied, those variations are limited to the type of regulated activity carried on and any requirements which may be imposed on the carrying out of that activity. The powers to vary a permission do not extend to a change in the legal status of the firm. Therefore, when a partnership becomes an LLP, or indeed when an individual wishes to carry on business as a body corporate, a new application for permission must be made.

(b) Does the Treasury consider that it would be sensible to deal in this RRO with the issue of authorisation of LLPs succeeding to the business of a dissolved firm?

The need to authorise afresh is a reflection of the organisational flexibility of an LLP, which potentially allows for widely differing organisational structures. That flexibility means that all of the members can be involved in the day-to-day management and operations of the business (unlike the position in a traditional partnership). It is this feature which requires the proposed structure of a particular LLP to be explained fully by an applicant LLP for Part IV permission.

If a partnership wishes to change its legal status to an LLP then a change of legal status application would need to be submitted. The application is assessed in the same way as a new authorisation and the new LLP will still have to meet the threshold conditions. However, for change of legal status applications the FSA operates a

fast-track, lower cost authorisation procedure (on the basis that the FSA will already hold information on the firm currently authorised)

There may be many issues for the FSA to consider when a firm changes its legal status. For example:

- As a regulator charged with ensuring that customers are treated fairly, the FSA must understand what is happening to those customers' interests when an existing authorised firm proposes to change its legal status. This is because those customers could be at risk of losing their existing protection as a result of that change.
- The firm may be limiting its liability or exposing itself to greater liability.
- The way the firm can be financed and capitalised may be changing.
- The new firm may need to take out new professional indemnity insurance.
- The firm may become subject to new law such as the Companies Act.
- It is likely that some controlled functions the existing approved persons perform will change and approvals are required.

It is for these reasons that the Treasury considers that the status quo should remain in respect of LLPs.

FSA consultation with EEA regulators [section 49(2) of the FSMA]

Q3. (a) If the Treasury is of the view that this notification does not constitute consultation within the meaning of s49(2) of the FSMA, please confirm that Article 39 of the Consolidated Life Assurance Directive is irrelevant for the purposes of s49(2).

The Treasury agrees that Article 39 of the Consolidated Life Assurance Directive refers only to notification requirements. Section 49 of FSMA relates to consultation prior to authorisation and is not relevant for the purposes of Article 39. The reference in the Explanatory Memorandum to the Consolidated Life Assurance Directive was included in error. The reference should have been to Article 12a of the First Non-Life Directive (73/239/EC) as amended by the Conglomerates Directive (2002/87/EC) which does contain prior consultation requirements.

(b) Alternatively, if the Treasury considers that notification pursuant to Article 39 does fall within the meaning of consultation under s49(2) of the FSMA, please indicate how the Treasury intends to incorporate notification in relation to a withdrawal or lapse of authorisation into the proposed scheme for amending s49(2).

Not applicable. Please see response to question 3(a).

Cancelling sponsor approval [section 88 of the FSMA]

Q4. Please explain the justification for not granting a right to sponsors to petition the Tribunal in cases where their request for cancellation of approval is refused by the FSA.

It is not felt that this protection is necessary for the cancellation of sponsor approval. A sponsor essentially carries out a support function. S/he is approved by the FSA to perform services on behalf of others, as required by the listing rules. The approval does not relate to a firm's ability to carry on business, unlike the listing of a security. A sponsor is merely approved by FSA to act as such. It is the sponsor's choice whether or not to act.

Taken together, the Government considers it is much more important for an issuer to be able to challenge a FSA decision and to protect their rights and freedoms given the impact on their ability to do business resulting from such a decision.

Q5. What assurances can the Treasury provide that, in the absence of any proposals in the RRO about announcements to the market, the market will receive clear and up to date information about approved sponsors?

The FSA currently maintains a list of sponsors on its website (http://www.fsa.gov.uk/pubs/ukla/SP_register.pdf) and this is updated to reflect the fact that a firm has been removed from the list. The FSA is currently considering how best to ensure that the cancellation of a sponsor's approval is communicated and publicised; FSA will consult publicly on its proposed approach on this issue in due course.

Removing restrictions on waivers and modifications [section 148 of the FSMA]

Q6. Will such waiver or modification apply to a class of persons, or only to individuals? Please provide examples to illustrate your answer.

FSMA does not enable the FSA to grant a waiver which applies to a class of persons without their individual consent. Typically, a waiver or modification is granted on the application of an individual firm. However, the FSA sometimes offers what are termed "waivers by consent". This tends to happen where it becomes apparent that a waiver given to a particular firm could apply to a number of firms in the same position. Here, the FSA informs the firms concerned that a waiver or modification is available (by publishing details of the availability on the FSA website). The firms concerned do not have to make a formal application but instead provide the FSA with their written consent for the waiver to apply to them.

An example of one such modification currently available is the change to the way clients are contacted, for providers of Revenue-allocated Child Trust Funds (CTF). CTF Regulations (the Regulations) make provisions for CTF accounts under the Child Trust Funds Act 2004. 'Regulation 6' provides for the opening of accounts by HM Revenue & Customs (HMRC). The vast majority of these accounts will be opened by HMRC on behalf of children whose parents have failed to use their CTF voucher before it expired.

Regulation 6 requires account providers to open a stakeholder account in the name of the child as soon as they receive instructions from HMRC. Under its process, HMRC should tell the responsible person (for example, the parent) that the Revenue-allocated CTF has been opened, before the account provider contacts that person.

The modification will enable firms to provide safe custody services in respect of Revenue-allocated CTFs, before obtaining written agreement or giving notice as required by the FSA's rules CASS 2.3.4R and 2.3.2R. It will be available only to those firms that provide Revenue-allocated CTFs.

In relation to this particular modification, the FSA also intends to consult shortly on amendments to these rules to make these changes permanent. As a result, the modification will end if and when new rules come into force. Any rule changes will be subject to the FSA's consultation process.

Further examples are available on the FSA's website at <http://www.fsa.gov.uk/Pages/Doing/Regulated/Notify/Waiver/Consent/index.shtml>

Q7. To the extent that a rule is being modified, how will the FSA decide the appropriate level of modification of that rule? Please provide examples to illustrate your answer.

The FSA judges applications for waivers or modifications against criteria set out in section 148(4) of FSMA. This states that it can only direct that a rule should not apply (or should apply) in a modified way only if the FSA is satisfied that:

a) compliance with the rules, or with the rules as unmodified, would be unduly burdensome or would not achieve the purpose for which the rules were made;

and

(b) the direction would not result in undue risk to persons whose interests the rules are intended to protect.

Ordinarily it is up to a firm to apply to the FSA, explaining why it believes that a particular rule (or group of rules) is unduly burdensome, etc. - and the arguments advanced are often specific to that firm's circumstances. Of course, the FSA can only waive or modify rules to the extent that this would be compatible with European law including Directive requirements.

An example of how the FSA uses this power is as follows. Under FSA rules a firm may not include in its calculation of capital resources economic reserves known as "implicit items" (in relation to long-term insurance business this could be economic reserves arising in respect of future profits, zillmerising⁷⁵ or hidden reserves), except subject to a waiver under FSMA s.148. The Consolidated Life Directive provides that implicit items can be included in the calculation of a firm's capital resources, within limits, provided that the supervisory authority agrees. Firms may apply to the FSA using the s.148 mechanism to obtain its agreement. A firm applies stating the nature and the amounts of the implicit items that it wishes to count against its capital resources requirement. The amount of the implicit item that the FSA will permit a firm to count depends on the firm's particular financial circumstances. The firm will submit quite detailed financial data to support its application and, on a case by case basis, the FSA will decide whether to grant the waiver requested and if it does so the amount of the implicit item that can be included. The FSA will not necessarily grant a waiver for the full amount of the implicit item which could be granted. Rather, it will decide each application according to whether - and the extent to which - it considers that a firm has met the FSMA s.148(4) tests in its individual circumstances.

Lighter consultation on guidance [section 157 of the FSMA]

Q8. (a) Please explain with reference to the text of the FSMA the legal status which the Treasury considers applies to guidance issued by the FSA acting under powers given in s. 157(1)?

The Treasury is not reducing the requirement to consult. Representations relating to draft guidance may still be made to the FSA. The Treasury is also retaining the existing requirement that the FSA must have regard to any representations before it makes the proposed guidance.

The Treasury's proposal is limited to removing the additional requirements which apply to the issue of proposed guidance. These additional requirements are the need to provide:

- a cost benefit analysis;
- an explanation of the purpose of the guidance;
- an explanation of the FSA's reasons for believing that the proposed guidance is compatible with its general duties;
- an account of representations made and the FSA's response to them; and
- an account of any difference between the proposed guidance and the guidance made, including a cost benefit analysis where the difference in cost is more than minimal.

There is no requirement in FSMA which provides that guidance is binding on an authorised person to which it applies. This is in direct contrast to statements of principle relating to conduct of business, for example, issued by the Bank of England under the Financial Services Act 1986. Failure to comply with a statement of principle was specified as a ground for taking disciplinary action. This is not the case with guidance issued under FSMA. The FSA has stated that although a person acting in accordance with guidance will be treated as

⁷⁵ The method known by that name for modifying the net premium reserve method of valuing a long-term insurance contract by increasing the part of the future premiums for which credit is taken so as to allow for initial expenses.

if they have complied with the relevant rule, guidance need not be followed in order to achieve compliance. Instead, guidance is intended to help persons to whom the rules apply to understand them and to comply with them. The FSA's reader's guide to the handbook states that "whatever guidance is used for, it is **not binding** on those to whom the Act and rules apply, nor does it have 'evidential' effect. It need not be followed in order to achieve compliance with the relevant rule or other requirement. So a firm cannot incur disciplinary liability merely because it has not followed guidance. Nor is there any presumption that departing from guidance is indicative of a breach of the relevant rule".

The status of guidance issued under FSMA contrasts also with the status of both planning and health and safety guidance. With regard to planning guidance, the Planning and Compulsory Purchase Act 2004 provides that a local planning authority must have regard to guidance issued by the Secretary of State. Under the Health and Safety at Work Act 1974, a local authority, or other body responsible for the enforcement of the Act's provisions must perform its duties in accordance with guidance. Thus for an applicant for planning permission or an employer responsible for compliance with the 1974 Act, the planning policy guidance or health and safety guidance has a far more immediate and direct effect on their actions than any guidance issued by the FSA would have on an authorised person.

(b) On what basis does the Treasury claim that a Tribunal or court would not use the guidance as at least indicative of the way in which the rules should be applied, given that that guidance is issued by the rule-making body?

The Treasury would expect a court or Tribunal to be made aware of guidance relating to particular rules and to view such guidance as describing the FSA's expectations. But this does not mean that the Tribunal would accept that the FSA's view was the right construction of what the rule required or consider that the person subject to disciplinary action was required to act in the manner suggested by the FSA. For example, in the context of assessing a person's "fitness" to perform a regulated activity, the Financial Services and Markets Tribunal has described the FSA's guidance about the relevant test as being "very helpful" but not "legally binding" (Manchanda -v- FSA, May 2006).

The FSA is consulting on text to go into its proposed Enforcement Guide which explains what it regards as the relevance of guidance, especially in the context of enforcing the FSA's Principles for Businesses, as follows:

"Guidance (whether it takes the form of guidance in the Handbook or the form, for example, of a case study or generic letters written by the FSA to Chief Executives in particular sectors) is, however, potentially relevant to an enforcement case and is material that a decision maker may take into account in considering the matter. The sorts of ways in which guidance is likely to be relevant include the following:

- (1) To the question of predictability, where it illuminates the FSA's view of the application of the Principle.
- (2) To explain the regulatory context.
- (3) To inform a view of the overall seriousness of the breaches e.g. the decision maker could decide that the breach warranted a higher penalty in circumstances where the FSA had written to Chief Executives in the sector in question to reiterate the importance of ensuring a particular aspect of its business complied with relevant regulatory standards.
- (4) To inform the consideration of a firm's defence that it could not have appreciated the FSA's expectations in the area in question and/or that the FSA was judging the firm on the basis of retrospective standards.
- (5) To be considered as part of expert or supervisory statements in relation to the relevant standards at the time.

The relevance and appropriate weight to attach to guidance will depend on all the circumstances of the case, including the nature of the firm's defence. It is for the decision maker - whether the Regulatory Decisions Committee, Tribunal or an executive decision maker - to determine this on a case-by-case basis." The link below, to the draft Enforcement Guide (see paragraph 2.21), sets out the abovementioned position http://www.fsa.gov.uk/pubs/cp/cp07_02.pdf.

(c) **Please provide some examples to illustrate the Treasury's responses.**

Please see the answers to questions (a) and (b) above.

Q9. Please explain how s157(3) currently allows for a lighter-touch consultation process

Section 157(3) of FSMA states that the FSA is only required to consult on guidance in relation to rules to which regulated persons generally or a class of regulated persons are subject. This means that information or advice to consumers which relates to rules to which regulated persons are not subject may be issued without consultation.

In providing guidance in relation to rules to which regulated persons generally or a class of regulated persons are subject, elements of section 155 apply. A lighter touch consultation procedure can already be accommodated within these existing powers. Crucially, section 155 makes no requirement as to the length of a consultation period and it is entirely possible for the FSA to carry out a short consultation of 28 days for minor matters or matters of urgency.

Additionally, section 155(1) requires the FSA to publish a draft of proposed rules in the way appearing to it to be best calculated to bring them to the attention of the public. This does not preclude the FSA from limiting the publication of proposed rules/guidance on its website.

Delegating the issue of guidance [Sch 1, para 5 of the FSMA]

Q10. What assurances can the Treasury give that the FSA will issue a policy statement dealing with [the operation of the new arrangements, in particular, how consistency, quality and publication of guidelines is to be assured as well as explain the membership of the committee or sub-committee and how it would be held accountable]?

The FSA sees the consultation document as giving it a clear steer in this area and is currently considering how best to operate the arrangements permitted under the RRO. The FSA will publish a statement of how this will work – including the aspects the committee has raised – before making any guidance using this process.

I hope that this answers the committee's questions. Please contact me if there is any further information that the committee requires.

19 February 2007

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