

A brief overview of the Financial Services Act 2012 and the new UK financial regulation framework

From 1 April 2013, a new financial regulation framework will be operative in the UK. The Financial Services Authority (FSA) is being replaced by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA), the Bank of England is to have overall responsibility for financial stability and a new Financial Policy Committee (FPC) of the Bank of England is being created.

However, the Financial Services Act 2012 does more than just give effect to these regulatory reforms. In this briefing we provide an overview of the new framework and summarise some of the other main areas of change, including the resolution powers under the Banking Act 2009 and the law relating to market manipulation.

1. Overview

The Financial Services Act 2012 implements significant changes to the UK financial regulation framework by amending the relevant provisions of the Financial Services and Markets Act 2000 (FSMA). In addition, the 2012 Act will:

- restructure and broaden the law relating to market manipulation and misleading statements and impressions;
- extend the scope of the special resolution regime under the Banking Act 2009;
- create a new category of regulated activity in relation to benchmarks (e.g. LIBOR) and credit ratings;

- change the regime for the approval, supervision and discipline of sponsors under FSMA; and
- allow the regulation of consumer credit to be transferred to the FCA.

2. Who's who in the new financial regulation framework

- The **Prudential Regulation Authority (PRA)** is a subsidiary of the Bank of England. It will be responsible for the prudential regulation of deposit takers, insurers and major investment firms.
- The **Financial Conduct Authority (FCA)** will be

Timeline

1 April 2013:

- New UK financial regulation framework comprising Bank of England (including FPC), PRA and FCA
- Market manipulation laws restructured and broadened
- Changes to approval, supervision and discipline of sponsors under FSMA

Summer 2013(?):

- Resolution powers under Banking Act extended to certain UK investment firms, certain group companies of UK banks and UK investment firms, and UK clearing houses

Timing not yet clear:

- Regulation of certain activities in relation to benchmarks (e.g. LIBOR) and credit ratings
- Transfer of consumer credit regulation to the FCA (expected to be effective April 2014?)

responsible for conduct regulation and also for the prudential regulation of non-PRA firms (i.e. smaller investment firms, exchanges and other financial services providers). It will replace the FSA as the authority responsible for the official list under Part 6 of FSMA.

- The **Financial Policy Committee (FPC)** will be primarily responsible for assisting

the Bank of England in achieving its financial stability objective and will be given powers of recommendation and direction (to the FCA or the PRA) to address systemic risk.

- The **Bank of England** will have overall responsibility for financial stability. The Bank will also be the appropriate regulator for recognised clearing houses and will have the power to direct a UK

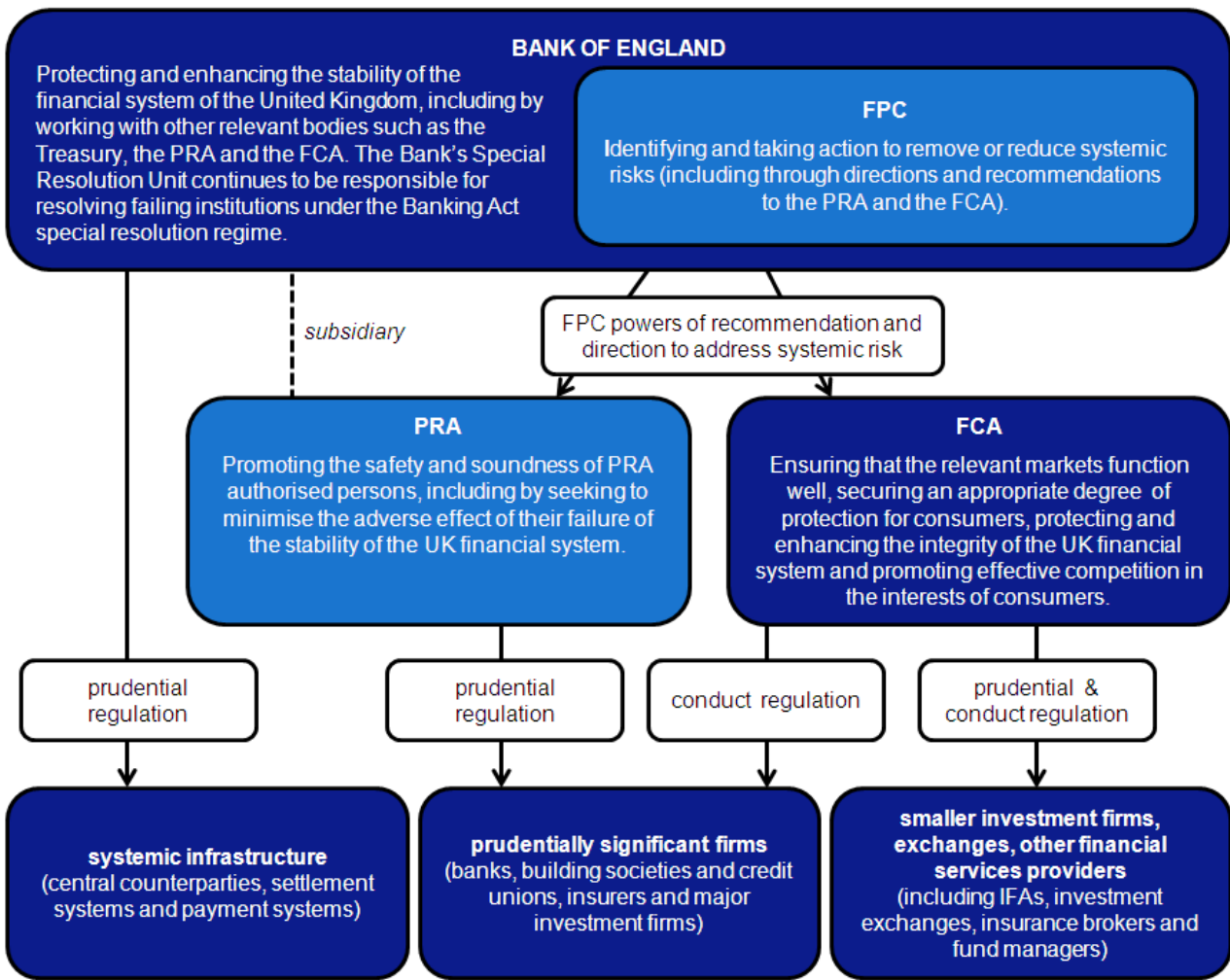
clearing house in certain circumstances.

See section 5 below for more detail.

3. Misleading statements and impressions offences

The 2012 Act will restructure and broaden the ambit of the law relating to market manipulation and misleading statements and impressions.

Roles of the bodies in the new regulatory architecture



This is a modified version of the diagram on page 10 of HM Treasury consultation "A new approach to financial regulation: building a stronger system", February 2011

The existing offence, for misleading statements and practices, under section 397 of FSMA is being repealed and replaced by three separate offences:

- misleading statements (section 89 of the 2012 Act);
- misleading impressions (section 90 of the 2012 Act); and
- misleading statements etc in relation to benchmarks (section 91 of the 2012 Act).

Together, the new misleading statements and misleading impressions offences largely cover the same ground as the existing single offence under section 397 of FSMA. However, the misleading impressions offence will be slightly broader than its predecessor in that it includes misleading impressions made recklessly in addition to those made intentionally.

The new offence for misleading statements etc in relation to benchmarks is being introduced in response to the final report of the Wheatley Review of LIBOR, which recommended that the criminal law should be amended to cover manipulation of LIBOR.

4. Changes to the Banking Act 2009

Not all of the legislative change being made by the 2012 Act is scheduled for implementation on 1 April 2013. The 2012 Act will also be making changes to the Banking Act 2009, including the extension of the special resolution regime (which is currently available in respect of UK banks and building societies) to certain UK investment firms, certain group companies of UK banks and UK investment firms, and UK clearing houses. Implementation dates for the majority of the changes to the

Banking Act 2009 have not yet been provided (although we understand, from the Treasury, that summer 2013 is a possibility).

5. Roles and powers of the new regulators

Prudential Regulation Authority

The PRA will be responsible for promoting the stable and prudent operation of the financial system through the regulation of all deposit-taking institutions (banks, building societies and credit unions), insurers and the major investment firms (together, PRA-authorized persons).

The PRA's general objective is to promote the safety and soundness of PRA-authorized persons. To advance that objective, the PRA will seek to ensure that the business of PRA-authorized persons is carried on in a way which avoids any adverse effect on the stability of the UK financial system. It will also seek to minimise the adverse effect that the failure of a PRA-authorized person could be expected to have on the stability of the UK financial system. Additionally, commensurate with its responsibility for regulating insurers, the PRA has an insurance objective: to contribute to the securing of an appropriate degree of protection for those who are or may become policyholders.

In discharging its general functions, the PRA is to have regard to the regulatory principles applicable to both the PRA and the FCA and also to the need to minimise any adverse effect on competition in the relevant markets.

The 2012 Act also makes provision for the setting of further objectives.

Financial Conduct Authority

The FCA will be responsible for regulation of conduct in retail, as well as wholesale, financial markets and the infrastructure that supports those markets. The FCA will also have responsibility for the prudential regulation of firms that do not fall under the PRA's scope.

The FCA's strategic objective is to ensure that the relevant markets function well. Its operational objectives are: to secure an appropriate degree of protection for consumers; to protect and enhance the integrity of the UK financial system; and to promote effective competition in the interests of consumers in the markets for regulated financial services or services provided by a recognised investment exchange in carrying on exempt regulated activities. The FCA is tasked with maintaining arrangements for supervising authorised persons, monitoring compliance and taking enforcement action.

The FCA will have a wide range of rule-making powers, which in some cases go beyond the powers currently enjoyed by the FSA.

For example, the FCA will have the power to make product intervention rules, prohibiting authorised persons from entering into specified agreements if the FCA considers it to be necessary or expedient for the purposes of advancing the consumer protection objective or the competition objective (the Treasury may by order extend this to include also the integrity objective). Contravention of a product intervention rule could lead to the relevant agreement or obligation being unenforceable against any person or specified person, and to the recovery of money

paid or property transferred and to the payment of compensation.

Co-ordination and co-operation

The PRA and the FCA have a duty to co-ordinate the exercise of their functions.

In certain circumstances, the PRA may, if it considers it necessary, direct the FCA to refrain from exercising its regulatory or insolvency powers in relation to PRA-authorized persons if the PRA is of the opinion that the exercise of the power in the manner proposed may threaten the stability of the UK financial system or result in the failure of a PRA-authorized person in a way that would adversely affect the UK financial system.

Both the FCA and the PRA must take appropriate steps to co-operate with the Bank of England in connection with, among other things, the Bank's pursuit of its financial stability objective.

Financial Policy Committee

The FPC is a sub-committee of the Court of Directors of the Bank of England, consisting of the Governor of the Bank, the Deputy Governor of

the Bank, the Chief Executive of the FCA, a member appointed by the Governor of the Bank after consultation with the Chancellor of the Exchequer, four members appointed by the Chancellor of the Exchequer and a representative of the Treasury.

The FPC is primarily responsible for contributing to the achievement by the Bank of its financial stability objective (the FPC also has a role in supporting the economic policy of the Government, including its objectives for growth and employment). To this end, the FPC will identify, monitor and take action to remove or reduce systemic risks with a view to protecting and enhancing the resilience of the UK financial system.

Those risks include systemic risks attributable to structural features of financial markets, such as connections between financial institutions, systemic risks attributable to the distribution of risk within the financial sector, and unsustainable levels of leverage, debt or credit growth.

The FPC may give directions to the FCA or the PRA requiring them to exercise their functions so as to

ensure the implementation of a macro-prudential measure (prescribed by the Treasury by order) described in the direction.

In addition, the FPC may make recommendations within the Bank, including as to the provision by the Bank of financial assistance to financial institutions and the exercise by the Bank of its functions in relation to payment systems, settlement systems and clearing houses.

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