

The New UK Financial Services Act 2010 Makes Significant Reforms; FSA Wins Reprieve From Abolition

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The Financial Services Act 2010 (the FS Act) received Royal Assent on 8 April 2010. The FS Act is a legislative response to the causes of the global financial crisis, delivering significant reforms that seek to enhance financial regulation. The FS Act mainly amends the Financial Services and Markets Act 2000 (the FSMA) in order to give the UK Financial Services Authority (FSA) new objectives and duties and extend its powers variously. Under the considerable time pressure induced by the calling of the UK general election for 6 May 2010 and the consequential shortening of the 2009-2010 parliamentary session, the then UK Government dropped the most politically contentious provisions of the Financial Services Bill (the Bill) to get it passed during the “wash-up” process which takes place in the period between the calling of a general election and the dissolution of Parliament.

The new UK Coalition Government has announced that it will not pursue the policy of the Conservative Party when in Opposition to disband the FSA dividing its responsibilities between the Bank of England and some new agencies.

New Statutory Objective: Financial Stability

Under FSMA, FSA currently has four statutory objectives which act as guiding principles for FSA when determining how it should exercise its statutory powers and frame the scope of many of its powers. These are: (i) maintaining confidence in the financial system; (ii) promoting public awareness of the financial system; (iii) protecting consumers; and (iv) reducing financial crime. The FS Act provides FSA with an explicit financial stability objective with immediate effect. In considering this objective FSA must have regard to the economic and financial consequences of instability and the possible impact on UK financial stability of events and circumstances outside UK. Also, FSA’s rule-making, permission and intervention powers are made exercisable for the purpose of meeting any of the FSA’s regulatory objectives, not just the consumer protection objective.

Powers To Require Information

The FS Act confers extensive powers to require information on FSA where FSA considers such documents and information “are, or might be, relevant to the stability of one or more aspects of the UK financial system.” FSA is explicitly empowered to require information and documents from investment funds whose assets consist of or include financial instruments which are traded in the UK or were issued by a body incorporated in the UK, their managers and investors. These provisions, which take effect on June 8, 2010, will, therefore, apply to long only funds and alternative asset funds (e.g. hedge, private equity, real estate and other alternative asset funds), their investment managers, administrators and investors.

Enforcement Powers

The FS Act extends FSA’s enforcement powers in accordance with its stated intention of building a reputation as a robust enforcer. From June 8, 2010, FSA will be able to: (i) suspend the permission of an authorised firm to carry on regulated activities where FSA considers it has contravened a regulatory requirement; (ii) impose a financial penalty and cancel a firm’s authorisation where it is in breach of a regulatory requirement; (iii) impose financial penalties for performance of controlled functions without approval; and (iv) suspend or impose restrictions on an approved person who is guilty of misconduct. In addition, the FS Act extends the limitation period within which FSA must take disciplinary action against an approved person from two to three years.

Short Selling

The FS Act empowers FSA to prohibit or require disclosure of short selling, including an express authority to make rules to ban short selling in financial instruments for specified periods without prior consultation. These rules would apply to all persons whether authorised by FSA or not and may apply to short selling by persons outside the UK, but only in relation to financial investments admitted to trading on UK markets. In formulating the rules, FSA must take account of any international agreement on short selling. The penalty for contravention is an unlimited fine or public censure. These provisions will come into force on June 8, 2010.

“Living Wills”

The FS Act with immediate effect imposes a duty on FSA to require authorised firms to prepare and maintain recovery and resolution plans (RRPs), so-called “living wills,” and gives FSA formal enforcement powers relating to the collection of information relating to RRP. The purpose of these RRP is to enable third parties (such as other authorised firms or administrators) to carry on an authorised person’s business in the event of the likely or actual failure of that authorised person’s business. FSA is given discretion over which authorised firms are required to introduce RRP, allowing them initially to focus on the largest, most complex and systemically significant firms.

Remuneration

HM Treasury is empowered with immediate effect to make regulations which require authorised firms to prepare, approve and disclose remuneration reports covering their executives, officers, employees and consultants. From 8 June 2010, FSA is obliged to make rules requiring authorised persons or a specific class thereof to have and comply with a remuneration policy which is consistent with effective risk management. If FSA believes a remuneration policy is not compliant, it may take steps to deal with the failure, which can include requiring the policy to be revised, and FSA may specify that certain remuneration agreements in breach of its remuneration rules are void. These new provisions provide clearer legislative backing for the FSA’s Remuneration Code which came into force on January 1, 2010.

Consumer Protection

With immediate effect, the FS Act requires FSA to establish a new consumer financial education body to educate the public on financial matters and the management of their own financial affairs; FSA’s objective of promoting public understanding of the financial system will be removed from a date to be decided. The FS Act contains provisions which, when commenced, would enable FSA to require firms to operate consumer redress schemes where consumers have suffered loss in cases involving large scale consumer mis-selling or other failures and, in the consumer credit arena, introduce restrictions on the issuing of unsolicited credit card cheques to individuals.

“Wash-Up” Process

In the interests of the Bill surviving the “wash-up” process, the predecessor Government dropped its proposals for: (i) the creation of a Council for Financial Stability – a new body to co-ordinate the responsibilities and action of the Bank of England, HM Treasury and FSA with respect to matters of financial stability; (ii) a new duty on FSA to promote international regulation and supervision; and (iii) collective court actions – new provisions to allow the courts to authorise collective proceedings brought by consumers where a mass failure of practice has affected a significant number of consumers. Given the change of Government, those proposals are unlikely to resurface. The predecessor Opposition agreed to drop a clause on disclosure to Parliament by HM Treasury of financial assistance given to the Bank of England.

FSA Wins Reprieve

The FSA will not after all be disbanded by the new Government. Instead a new committee chaired by the Governor of the Bank of England will oversee macro-prudential regulation and the new Chancellor will chair an independent commission that will investigate whether big British banks should be broken up by separating retail banking from investment banking. FSA will continue to regulate banks.

FSA has published a consultation paper on its proposed use of its new powers and duties under the FS Act. Following consultation, FSA expects to issue a Policy Statement in July 2010. We will keep you informed of developments.

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