

UK Financial Services Regulatory Focus

Providing up-to-date and authoritative insights into UK financial services regulation*

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It would be surprising if this edition of UK Financial Services Regulatory Focus did not have significant coverage on the Markets in Financial Instruments Directive (MiFID) given the significance of the FSA's issuance of CP 06/19 and CP 06/20 in late October, and indeed we have included two articles which focus on the key elements of what these consultation papers have to say. In our European watch article we bring readers up to date with Level 3 developments from the Committee of European Securities Regulators (CESR). However, the FSA's proclamation that its Damascene-style conversion to principles-based regulation is fulfilled in the issue of the New Conduct of Business Handbook – NEWCOB – merits more comment.



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PricewaterhouseCoopers LLP's Financial Services Regulatory Practice comprises over 125 partners, directors, managers and staff dedicated to providing proactive regulatory advice to authorised firms and other financial institutions within the UK, Europe and worldwide. Our team blends the experience of former senior regulators, compliance managers, industry personnel and staff from an assurance/client-facing background, to provide clients with an unparalleled knowledge of the regulatory rules, codes of conduct and the prudential supervisory framework.

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As expected, the FSA has plumped for what is essentially intelligent copy out of the MiFID Level 2 directive material, with limited guidance, despite its short-lived dalliance with the idea of issuing guidance on the desirability of external benchmarks for proving best execution. Its press release at the time made great play of this as an example of principles-based regulation, but the material in the consultation papers and draft rulebook remains detailed at over 1,600 pages. In our view, the FSA has some way to go before all hearts and minds within 25 North Colonnade are won over fully to principles-based regulation, and before the compliance profession is unstinting in its support for the change. Principles are more difficult to enforce than rules, though the FSA is clearly headed in that direction. The compliance profession and their regulators, together with consultants and advisers, will need to work carefully to ensure that there is something to fill the gap left by the withdrawal of current guidance material if many firms are not to struggle with practical application of NEWCOB, and if the move to principles-based regulation is to be complete rather than aspirational.

Another publication of interest is Discussion Paper 06/05: FSA confirmation of industry guidance, which sensibly lays out conditions that will need to be satisfied before guidance developed by the industry – including trade associations. Indeed the paper goes further in prescribing good practice which will be supported by the FSA but which goes beyond the material in 'maximum harmonisation' directives. The demand for public availability of such guidance, and the fact that it should clearly not be anti-competitive, as well as considering consumer interests and views, may make this a less attractive route for trade associations, particularly those representing smaller firms. It is, nevertheless an important route to the maintenance of higher standards in the industry, and the FSA's approach should be welcomed.

The role of the CESR as the relevant Level 3 body remains important, and its consultation on interpretational issues in respect of MiFID is indicative of the way in which the application of such directives is likely to develop. Many firms may bemoan the fact that interpretation is to be further from their control in Brussels or Paris, but the real drive to obtain consensus at the CESR on a number of key interpretational issues is very important for practical application of MiFID by firms which operate across Europe, particularly in respect of home/host relationships, on which it consulted in December.

Insurers and other firms not covered by MiFID may well be wondering whether they can keep their heads down and await Solvency 2, probably not to be implemented before 2010. However, this is not so: the FSA is intending to apply many of the MiFID provisions and principles-based approach to them too in the interests of not confusing investors. This was confirmed in the recent Policy Statement PS 06/13: Organisational systems and controls – common platform for firms, in respect of systems and controls requirements.

The Capital Requirements Directive or Basel II continues the process of becoming embedded in Europe. The issue in the UK of the General Prudential Sourcebook (GENPRU) and the Prudential Sourcebook for Banks, Building Societies and Investment Firms (BIPRU) largely brings to a conclusion the changes to the rule book. However, the process of obtaining waivers for Internal Ratings Based approaches to credit risk and Advanced Management Approaches to operational risk, alongside approval of counterparty credit risk models to provide Effective Expected Potential Exposure for the Trading Book, has yet to run its course. The application of Pillar 2 with the Internal Capital Adequacy Assessment Process followed by Supervisory Review from the FSA will allow firms to see how Basel II actually works in practice. We include an article on Pillar 2, a further article on the FSA's requirement for thorough stress testing approved by management, both of which will provide challenges to firms over the coming months, and a useful article explaining where our U.S. cousins have got to thus far on Basel II.

The FSA is turning its attention to many other areas: the focus on the risks inherent in the Private Equity sector has been the subject of a discussion paper which is well described in an article in this issue. The management of collateral by investment banks, too, is to become an area of close focus with statements of good practice expected in due course. Finally, we address two other areas of concern in the sector: the Single European Payments Area (SEPA), and the risks inherent in the Alternative Investment Market.

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CP 06/19 Reforming Conduct of Business regulation

There are now fewer than 12 months until the Markets in Financial Instruments Directive (MiFID) goes live in the UK and across Europe.

As part of the UK preparations for MiFID the Financial Services Authority (FSA) released its final two consultation papers incorporating changes required by MiFID on 31 October 2006. The Consultation Papers – CP 06/19: Reforming Conduct of Business Regulation, which included the draft Handbook text for the New Conduct of Business Handbook (NEWCOB) and other miscellaneous provisions; and CP 06/20: Financial promotion and other communications, provide approximately 800 pages of light reading.

This article looks at some of the changes and impacts of MiFID on NEWCOB.

The FSA approach

As part of the FSA's move towards a principles-based regulation, it has adopted a high-level rules-based approach to NEWCOB including those sections impacted by MiFID. In most of the areas of NEWCOB where MiFID has been relevant, the FSA has adopted an 'intelligent copy-out' approach. This has meant that most of the MiFID Level 2 requirements have been included in their original form with some, but not many, changes from the Level 2 Directive. The guidance provided by the FSA has been minimal but it could be seen as helpful in a number of areas.

Impact areas

Those who have been following the debate closely will have been relieved by the contents of CP 06/19, but that does not mean that there will not be some tricky issues to address. The main, but not the only, areas of impact covered by the last consultation papers include client classification, best execution, and the

introduction of the appropriateness test. We explore each of these in turn below.

Client classification

While not much has changed on client classification requirements from the informal paper issued in August, there will still be the need to invest significant time and deal with significant challenges including:

- The effort needed to undertake the reclassification exercise where the grandfathering provisions do not apply.
- Drafting and/or changing client documentation in relation to relevant policies, for example execution and conflicts policies.
- Ensuring static data and/or customer relationship management systems are able to deal with the task, particularly those concerned with the quality of static data.

There are also a few areas of impact from the new client classification rules, for example, with grandfathering. While the FSA appears to have provided as much room as possible for grandfathering with guidance on 'automatic', 'transitional' and 'reviewed' grandfathering, where this is not possible clients will have to be 'newly categorised' and notified. In addition, the FSA believes that MiFID does not allow one firm (Firm A) to classify clients based on the grandfathered classification status which those clients have with another firm (Firm B) based on pre-MiFID classification processes.

Best Execution

There has been much heated discussion on the most effective and appropriate way to implement best execution over the

last few months after a discussion paper issued by the FSA suggested a benchmarking approach. The FSA has now backed down, and the current proposals are effectively a high-level copy out of MiFID and substantially the same as under Conduct of Business (COB).

MiFID obligations such as the requirement to provide best execution to professional clients (unless specific instructions are received to the contrary), and the application of a broader remit of what constitutes best execution under the current regime still means a number of changes will have to be made.

The proposals for best execution include that:

- Firms owe best execution both to retail and to professional clients, but not to eligible counterparties.
- Firms executing clients' orders are obliged to formulate an execution policy, make arrangements for its implementation, inform clients about the policy and obtain their consent to it, and review the effectiveness of the policy as well as monitor compliance with it.
- Best execution requirements may apply to firms providing an 'investment service' to a client, but can be disappplied by firms where they are merely performing an 'investment activity' (without having a client relationship where there would be an expectation that best execution will be provided).

Firms are continuing to analyse current business models to try to limit the application of the best execution provisions, reinforced by the creative use of client documentation, but in our view

The appropriateness test is a new requirement for the UK and is a test that sits between suitability (for investment advice and portfolio management scenarios) and traditional execution-only.

the FSA has now ceded all the ground it intends to over what constitutes a client order and how these should be processed. The regulator is, in our view, unlikely to allow lawyers to circumvent a cornerstone of the legislation.

Appropriateness test

The appropriateness test is a new requirement for the UK and is a test that sits between suitability (for investment advice and portfolio management scenarios) and traditional execution-only. The test will only be applicable for those firms dealing with retail clients. Professional clients can be assumed to have the necessary experience and knowledge to understand the risks in the areas which have been deemed professional. The appropriateness test will apply:

- To all non-advised investment services involving complex products, AND non-complex products where the investment service is provided at the initiative of the firm.
- Where services a firm provides that are the result of personalised communications, such as 'direct offer'-type marketing. If these communications are personalised it could be seen to be inferring that the products are appropriate to the recipient's circumstances (see section below for further information).

In addition, if a firm gives a warning to a client to the effect that the client has not provided sufficient information for a firm to assess the appropriateness of a product, the firm can still continue to

proceed and effect the transaction on the instructions of the client. However, it should still consider the best interests of the client, taking account of the facts and circumstances.

What next?

From what we have seen, firms are currently at different stages of analysis and implementation of MiFID.

For those who have yet to analyse the impact of MiFID the FSA has, with these consultation papers alone, now provided over 1,600 pages from which firms can interpret, analyse, design and implement the changes necessary to meet MiFID's requirements.

With MiFID however, while the analysis is important, the implementation is even more so. Firms of all sizes, in our view, should now be beyond the phase of analysing the impacts of MiFID, and should be designing and implementing changes with the ownership and support of senior management and the front office.

For those who have not yet started on MiFID, it is time to roll up the sleeves, review the impacts on the business and start to implement the necessary changes.

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CP 06/20 Financial promotion and other communications



One of the consultation papers published on 31 October 2006 by the FSA deals specifically with its proposals concerning post-MiFID financial promotions and communications with customers, in conjunction with its ongoing MiFID initiative.

While consulting on MiFID changes, the consultation paper, CP 06/20: Financial promotion and other communications, also draws its source from the ongoing Treating Customers Fairly initiative and the FSA's Better Regulation Agenda, moving financial regulation towards principles and high-level rules.

The FPCP dovetails with the FSA's opus magnum on recasting the Conduct of Business rules (CP 06/19: Reforming Conduct of Business Regulation), which was published on the same day and which contains the fully amended proposed NEWCOB sourcebook. The FPCP proposes two of the NEWCOB chapters: chapter 4, dealing with communications to clients, and chapter 5, dealing with financial promotions.

The ideas

The FSA's approach in the FPCP is consistent with its announced objective of copying out MiFID provisions, taking these changes as an opportunity to shift the basis of regulation from detailed rules to high-level principles. The FSA wants firms to engage with these principles, develop internal systems to determine how to apply them and thereby 'internalise' the regulation and enrich it, rather than treating regulation as external information which can be treated by ticking boxes. Also, the FSA's performance verification will shift on this basis towards an 'outcome approach', where compliance is judged against the outcomes it produces rather than strict compliance with rules per se.

All communications (NEWCOB 4)

In line with MiFID, the FPCP contains the over-arching principle that 'all information' provided to customers must be clear, fair and not misleading. The FPCP proposes that this requirement be extended to include non-MiFID firms, as well as rules relating to the identity of firms and the accuracy of information.

Drawing on MiFID terminology, the concept of 'all information' is defined by the FSA as 'any communication, including marketing communications, between a firm and its client or potential client'. In addition, the new rules draw on MiFID's client categorisation rules, including for non-MiFID business.

Rules relating to comparative information and past performance only apply to non-MiFID firms in part, for example the FSA does not propose to extend the obligation to produce key facts and assumptions used to make comparisons to non-MiFID firms.

Financial promotions (NEWCOB 5)

The FSA proposes deleting most of its guidance as to what constitutes 'clear, fair and not misleading' in the context of financial promotions, with MiFID fleshing out some areas, such as comparisons and sufficiency of information, which apply to all communications.

The proposal also moves away from existing rules around disclosure of information to customers, which may allow for greater flexibility in the timing of disclosure in the context of direct offer financial promotions.

The FSA has proposed an 'appropriateness test' for complex MiFID products such as derivatives and warrants, which will be extended to all retail transactions in these securities, in essence obliging firms to ask customers to prove that a particular complex

Rules relating to comparative information and past performance only apply to non-MiFID firms in part, for example the FSA does not propose to extend the obligation to produce key facts and assumptions used to make comparisons to non-MiFID firms.

product is appropriate for them, based on their knowledge and experience.

Grandfathering clients

On the new client categories of Retail Client and Professional Client (with the sub-set of Eligible Counterparty), the FSA comments that MiFID provides scope to 'grandfather' current clients in their existing categories, in the case of retail and intermediate clients, without needing to re-paper or notify them. Of course the difficult bit is what to do with everybody else. For non-scope business, existing clients could be carried over into the MiFID categories with 'a minimum amount of re-categorisation required'.

FPO exemptions

The exemptions available under the Financial Promotions Order 2005 ('FPO 2005') will still be available as before for non-MiFID business. For MiFID business in connection with any MiFID instrument, the FSA states that the FPO 2005 exemptions will not be available and that the provisions of NEWCOB will apply instead. This approach may cause headaches for businesses which have been used to relying on the high-net worth individual, sophisticated investor and/or the sale of body corporate exemptions under FPO 2005.

Deregulation

The FSA suggests partial deregulation in a few specialist areas, such as not carrying forward separate Qualified Investor Scheme provisions, removing the

ban on direct promotions of broker funds and certain charging information in relation to direct promotion collective investment schemes.

The FSA has left the door open as regards the promotion of unregulated collective investment schemes, for consultation at a later stage.

Challenges for firms

Due to the removal of detailed rules, the proposed NEWCOB 4 and 5 are aesthetically very different from the current rules. Together with the unfamiliarity of certain MiFID terms, firms may legitimately wonder how best to ensure that they are not left rudderless when the changes take effect, it being understood that the ostrich approach to compliance is not a viable option.

As with many of its other recent initiatives, the FSA seems most concerned with senior management buy-in to the changes, and will be looking for evidence that senior management have connected with the principles in order to produce high quality (though not necessarily copious), systems and controls adapted to achieving the fair treatment of customers in the firm's specific business context.

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Pillar 2: stick or carrot?



Pillar 2 has important implications for the level of capital that banks hold and the way in which they manage risk and capital. Some see it as yet another regulatory stick, but is this fair?

Stress testing results are likely to be one of two major factors in determining Pillar 2 capital requirements. The other is the FSA's qualitative scalar, which is the capital consequence of the FSA's view on the relative strength of a firm's governance and control.

In October David Strachan, Director, Major Retail Groups Division of the FSA issued a 'Dear CEO' letter communicating the results of FSA thematic visits on stress testing, which are commented upon in a separate article in this edition.¹ The letter's recommendations warrant close attention. Fundamentally, the FSA concluded that most firms' stress tests are too mild. FSA research indicated that firms seem to find it difficult to imagine downside scenarios that are comparable to the severity of a 1-in-25 year economic downturn. A similar concern was echoed in the FSA's later warning in November to retail banks to ensure that they assess carefully the risks associated with

mortgages offered to first-time buyers on the basis of a five-times-salary multiple.

As well as encouraging banks to consider dark storm clouds in today's relatively benign credit climate, the 'Dear CEO' letter's recommendations included:

- Ensuring close senior management (i.e. 'C-suite') involvement in the development and challenge of stress tests.
- Integration of stress testing in other key business processes such as budgeting and planning – for example using the outputs to challenge business planning assumptions over a multi-year time horizon.

In microcosm these concerns and recommendations characterise the challenges of Pillar 2; and illustrate its far-reaching consequences. Addressing Pillar 2 and the need to demonstrate

conclusively and persuasively that a firm manages risk and capital in an integrated way is no small task. The principles of Pillar 2 Basel II and the Capital Requirements Directive are summarised in the table overleaf. These show its breadth and depth.

Admittedly many IRB firms have been up to their necks in preparing Pillar 1 Waiver Applications this year. As a result some of those in the earlier waves are only now turning to Pillar 2. A common first step in the regulatory process of Pillar 2 of drafting the outline of an Internal Capital Adequacy Assessment Process (ICAAP) usually identifies gaps that need to be bridged.

Let us not forget the banks that have opted for the standardised approach under Basel II. Because most of these firms do not yet use economic capital models, the significance of stress testing for the evaluation of the capital risks

¹ Page 11 – 'Stress testing: an opportunity?'

Pillar 2 principles

Principle 1 – Firm’s assessment of capital adequacy

‘Banks should have a process for assessing overall capital adequacy in relation to risk profile and a strategy for maintaining capital levels’

- Board and senior management oversight.
- Sound capital assessment.
 - Policies and procedures... to measure... all material risks.
 - Process to relate capital to level of risk.
- Comprehensive assessment of all risks.
- Monitoring and reporting.
- Internal control review.

impacts of all risks (i.e. not just credit) should not be underestimated. This is not just a calculation exercise; it extends to how the firms integrate stress testing into day-to-day risk and capital management.

As noted earlier, the qualitative scalar is also likely to have a major impact. Depending on the FSA’s view on the strength (or weakness) of governance and control, it has indicated that it will apply an adjustment of between -10% and +65% of its assessment of the firm’s capital requirements for both Pillar 1 and Pillar 2 risks. (These percentages are indicative estimates that may evolve as the FSA gains Supervisory Review and Evaluation Process (SREP) experience of firms’ ICAAPs; however the impacts are potentially enormous.) You may recall that PricewaterhouseCoopers prepared a Basel II impact study for the European Commission in 2004 which, using the banks’ own QIS3 data showed that, on average, EU banks could expect their Pillar 1 capital to be about 5% less than the current Basel I figure (calculated at 8% of risk-weighted assets).

In round terms this means that under Basel II Pillar 2 an add-on of up to 65% of the Basel I figure could be applied to a UK bank with relatively poor governance and controls (and an average business mix). There are few UK firms that are likely to fall into this punitive category, but even at the lower end of the scalar, the

Principle 2 – Supervisory review

‘ [Supervisors should]... review and evaluate banks’ internal capital adequacy assessments and strategies, as well as ability to monitor and ensure compliance with regulatory capital ratios. ...take appropriate action if not satisfied with the result of the process’

- Review of adequacy of risk assessment.
- Assessment of capital adequacy.
- Assessment of control environment.
- Supervisory review of compliance with minimum standards.
- Supervisory response.

capital numbers could be material, whether they are in the fortunate 0% to -10% band that actually receive a benefit or those with a relatively small add-on in, say, the 0 to +10% range. The current Individual Capital Ratio regime means that UK firms are already set a minimum capital ratio of over 8%. The ARROW system also means that UK firms have a good appreciation of the FSA’s current assessment of their governance and controls: the banks are no doubt considering the implications.

It should be apparent that those firms who are able to demonstrate convincingly

to the FSA that risk and capital are managed seamlessly will have a considerable advantage. In our experience of working with clients it is also apparent that there are major business advantages to be gained, independent of any regulatory impacts. Three examples are:

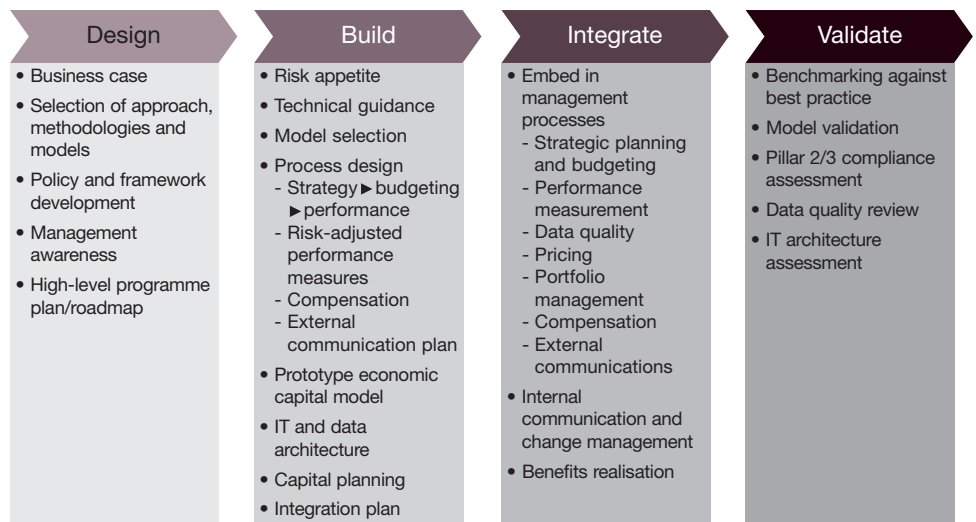
- More efficient use of capital.
- Better management of risk.
- New insights into the dynamics of the business.

PricewaterhouseCoopers uses an integrated framework called ‘Risk-based Capital Management’ which provides a comprehensive approach (see table below) supported by detailed methodologies. The table provides a useful high-level checklist of issues that firms should be considering.

Through the tried-and-tested carrot and stick psychology, Pillar 2 is emerging as a catalyst for positive change in the industry – which was, interestingly, the Basel Committee’s original intention.

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Risk-based Capital Management



Basel II implementation and related regulatory capital developments in the United States

The implementation of the advanced measurement approaches of the Basel II capital accord (the Accord) progressed with the 5 September 2006 joint issuance by the federal U.S. banking regulatory Agencies (i.e., the Federal Reserve Board, Comptroller of the Currency, Federal Deposit Insurance Corporation and Office of Thrift Supervision) of a Notice of Proposed Rulemaking (NPR), which revised and formalised the previously published draft by the Federal Reserve dated 30 March 2006.

Simultaneously issued were proposed revisions to the market risk capital amendment as well as companion (Pillar 3) regulatory disclosure requirements for both the Basel II and the revised market risk rules. Comments on these proposals are due by 23 January 2007.

The Basel II and the revised market risk rules will generally apply to large, complex internationally active banking organisations on a mandatory or an 'opt-in' basis. According to recent public comments by agency representatives, approximately one to two dozen U.S. supervised multi-bank holding companies are expected to be impacted initially by the Basel II capital rule and disclosure proposals. About 20 to 30 institutions, including savings associations, are expected to be impacted by the market risk rule revisions and disclosure proposal with substantial overlap among the two groups. As discussed below, the agencies will also be updating the current risk-based capital rules applicable to the remaining and majority of U.S. banking institutions.

The anticipated timing of final adoption in 2007 of these proposals is likely to widen the differences in implementation timing and in capital disclosures of competing institutions subject to Basel II in other jurisdictions. For example, Canadian institutions subject to the advanced internal measurement

approaches have begun parallel measurement and will be providing Pillar 3 reporting starting in fiscal year 2007. U.S. Supervisors acknowledge that over the next several years banking subsidiaries of foreign institutions will be subject to Basel I rules in the U.S while the consolidated parent is subject to Basel II and notwithstanding the need for the U.S. subsidiary's readiness as part of the group-wide Basel II qualification assessment. U.S. banks with foreign operations will need to choose Basel II approaches consistent with local requirements. The agencies continue to emphasise: (i) on-going informal feedback with institutions and their continued self-assessment of implementation readiness; and, (ii) that the agencies will not be in a position formally to 'pre-qualify' banks or segments of banks with respect to the Basel II rules until the rules are final.

The following highlights a few of the changes to the previous draft Basel II NPR as well as the new disclosure and market-risk NPR developments.

- **Basel II NPR:** There are about 40 areas of national discretion and clarification reflected in the Basel II NPR, some of which respond to comments received on earlier proposals and the 30 March 2006 draft NPR. The following are some representative examples:

- Introduction of Expected Loss Given Default (ELGD) parameter for calculation of expected losses rather than the Loss Given Default (LGD) parameter. ELGD, expressed as a percentage, is an estimate of the economic loss rate if a default occurs, whereas LGD, expressed as a percentage, is an estimate of the economic loss rate if a default occurs during economic downturn conditions.
- Requirement of seasoning into the retail loan portfolio's probability of default (PD) factor estimates.
- Exclusion of Expected Credit Loss (ECL) from the risk-weighted assets calculation; however, a bank must compare its ECL to its eligible credit reserves. If a bank's ECL exceeds its eligible credit reserves, the bank must deduct the excess ECL amount 50% from Tier 1 capital and 50% from Tier 2 capital. If a bank's eligible credit reserves exceed its ECL, the bank would be able to include the excess eligible credit reserves amount in Tier 2 capital (up to 0.6% of the bank's credit risk-weighted assets).
- Clarification that in estimating relevant risk parameters, banks should not rely on the possibility of U.S. government financial assistance, except for assistance that it is legally committed to provide. This may impact measures for government-sponsored enterprises and larger banking institutions that might be viewed as 'too big to fail'.

- **Pillar 3 and market risk disclosures:** There are specific public disclosure requirements on the capital structure, risk exposures, risk assessment processes, and, hence, the capital adequacy of a bank. The public disclosure requirements would apply only to the depository institution or bank holding company representing the top consolidated level of the banking group that is subject to the

advanced approaches. The agencies' proposal reflects a general presumption that the combination of current public disclosures in annual reports (including the management discussion and analysis and audited financial statements) together with the public portion of the proposed regulatory reporting disclosures, supplemented as needed by centrally accessible (i.e., web-based) supporting data sets should satisfy the Pillar 3 requirements.

- **Market risk:** The NPR for market risk takes into consideration the recent Basel/IOSCO revisions to the 1996 Market Risk Amendment and increasing sophistication in trading activities, as well as the wider range of risks that are not as easily captured in the existing value-at-risk models that underlie the market risk capital calculation. Examples of key revisions are:
 - Modification of the definition of a 'covered position' to include only true trading assets and trading liabilities limiting the 'arbitrage' among the credit and market risk measures of trading and banking book positions. This would affect the treatment of 'intangibles' (e.g. servicing assets) and certain residual securitisation positions and banking book hedging activities such as interest rate and credit derivative positions.
 - The requirement that risks arising from less liquid positions and positions with limited price transparency are to be modelled conservatively under realistic market scenarios. The market risk capital measurement model(s) must also include risks arising from the non-linear price characteristics of option positions.
 - Elimination of the option to model some, but not all, material aspects of specific risk for an individual portfolio of covered debt or equity positions. Following a transition period, after

2010, an institution that does not have an approved internal model that captures all material aspects of specific risk for an individual portfolio will be required to use a standard specific risk add-on for that portfolio.

The agencies are also preparing revisions to the current risk-based capital rules for institutions not subject to the Basel II proposal. A soon-to-be-issued 'Basel 1-A' NPR will take into account comments so far received on the Basel II proposals and the advanced NPR in October 2005 on Basel 1-A. The revisions are to address competitiveness concerns by smaller U.S. banks that have lately been raised in Congressional hearings and in comments to earlier proposals. Potential revisions include an increased number of risk-weight asset categories as well as expanded use of external credit ratings and increased recognition of financial collateral and guarantors to drive risk 'bucketing'. Recently, agency representatives have mentioned the possibility of an 'opt-in' for institutions to 'Basel I-A' revisions that could result in a three-tiered capital regime - i.e., current rules, Basel I-A and Basel II advanced approach.

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Creating an efficient European payments industry



Payment services can be broadly classified as either inter-bank systems processing high-value payments or bulk payment systems.

The inter-bank systems are typically used in the settlement of securities transactions, where the amounts involved are often large and the timing of settlement is integral to the process of transferring title to the securities. The bulk payment systems are associated with low-value payments such as payroll, domestic bills or payments for goods and services. In most European Union countries they are processed in huge numbers by Automated Clearing Houses (ACHs) with financial institutions settling the netted result of their customers' transactions. It is these high-volume low-value payments that are the focus of Single Euro Payments Area (SEPA).

SEPA is a piece of EU regulation which has been designed to create a unified framework for making payments either within a domestic market or on a cross-border basis. The objective is to open up the market for retail payments so that

consumers and companies are able to make cross-border payments for the same price and to the same service standards as domestic payments. This seems like a very laudable ambition. The effect should be to enhance the efficiency of the payments industry, reduce costs, improve cash flow for businesses and create a homogeneous European payments industry.

Although much work has already been completed, the remaining challenges are significant, as each country in the Eurozone has its own legislative framework governing payments, different products, infrastructure and standards. For example, within the SEPA countries alone there are nearly 40 different clearing systems with different settlement standards. These standards are embedded in the computer systems of the banks which in turn are linked to the systems used by companies for making payments. It is not hard to see why some

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commentators regard SEPA as being on a par with the year 2000 (Y2K) problem in terms of its scale and impact.

Is everyone a winner or will there be some losers?

The principle that will govern the likely target operational environment is that the highest standards must be adopted and no one should receive an inferior service to that which they enjoy in their domestic market. At present, however, across Europe there is a wide range of transaction fees charged for making payments. In certain countries payments are free to consumers who maintain a credit balance on their accounts, while in others there are charges. Furthermore, companies with significant payment volumes are able to negotiate payment fees. The question therefore arises over how much it will be possible to charge per transaction and whether there will be a potential for customers to look for cheaper payment services outside domestic markets.

SEPA will also require that payments are made more quickly than at present. It can take up to five working days between the funds being taken from a payer's account and being credited to the payee's account. During the extended settlement cycle banks are able to utilise these funds for their own benefit. By reducing the settlement cycle, SEPA will ensure that cash flows more efficiently between accounts and eliminate the bank's access to free funds.

In summary it appears that the benefits of SEPA will accrue to the users of payment services and the losers will be the providers of those services, notably

the financial institutions. Estimates for the cost of SEPA compliance vary but some put it as high as €8bn. In addition to this there is the potential loss of revenue which one survey has put at €39bn.

Changes in the business model

It is not only the scale of the capital investment required in delivering the SEPA payment model that will drive the thinking of banks on their response; they must also consider the wider implications for their business model and how the competitive environment might change as a result.

SEPA is likely to have a different effect depending on the jurisdiction. In some countries the banking system is consolidated around a few large players which control over 80% of the market, while in others, the banking system is highly fragmented. It could be that for smaller banks the provision of payment services may cease to be economically attractive if the revenues they are able to generate no longer cover the cost of providing the service. In a highly commoditised market, volumes will be critical as competition squeezes transaction charges.

This presents an opportunity for those institutions which have a pan-European or global reach and capability, a brand that other banks will trust and the capacity and infrastructure to offer an outsourced payment service. A service based solely on the making of a payment for a transaction fee is, however, unlikely to be particularly attractive, and it is to be expected that other value-added services and products are likely to be offered in order to maximise revenues.

SEPA only applies to payments under €50,000, although in theory this is a limitation which could rise over time and cloud the differentiation between payments processed through inter-bank systems and those processed through ACHs. While there is a value above which payments would settle on a gross basis for reasons of speed and risk management, there is nothing which says payments processed under SEPA rules have to be less than €50,000 and hence there is scope to define a service which goes beyond SEPA and could therefore provide revenues above and beyond a basic transaction fee per payment.

Furthermore, SEPA will potentially enable a corporate entity to consolidate its banking relationships and simplify the process of making cross-border payments. Additional benefits will arise from the harmonisation of processes, simplification of account structures and cash management. Any bank which is able to offer its customers a SEPA-compliant service with pan-Eurozone payments capability is likely to be at a strategic advantage, as those banks that cannot provide such a service will face either losing market share or using a third-party payment service.

Conclusion

In this short article it has not been possible to consider all the potential impacts of SEPA and explore them in any depth; indeed, we have not even considered the effect on the plastic card industry. Nevertheless there can be no doubt that the effect of SEPA on the financial services industry will be significant. Institutions need to be aware of the potential impact on revenues and how they can best meet the challenges.

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Stress testing: an opportunity?



In October 2006, the Financial Services Authority sent out a 'Dear CEO' letter from David Strachan, Director of Major Retail Groups Division, with regard to a thematic review of stress testing carried out by the FSA during quarters two and three of 2006 and the FSA's expectations arising from it.

The review looked at a sample of 10 large firms from the banking, building society and investment banking sectors of the market and focused on 'good practice' concerning stress testing and scenario analysis, as opposed to 'best practice'.

The FSA used the opportunity of this review to see how firms are able to manage their financial resources through adverse circumstances. The FSA expressed the view that stress testing is an important discipline and that principles 3 ('a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk-management systems') and 4 ('a firm must maintain adequate financial resources') are clearly applicable to this issue.

Within the letter, there is no simple formula for stress testing or scenario analysis; rather, there is an expectation that the larger and more complex institutions should move towards incorporating the principles of the comprehensive approach to stress testing that was outlined in DP05/2.¹ The six characteristics of the comprehensive approach to stress testing are:

- Senior management will be able to identify and articulate a firm's risk appetite and understand the implications of stress events within this context.
- Senior management will take an active part in identifying potential stress scenarios.

¹ FSA DP05/2 Stress Testing. May 2005. www.fsa.gov.uk/pubs/discussion/dp05_02.pdf

Stress testing: an opportunity?

- Outputs from stress testing will be communicated to senior management in comprehensible format.
- Senior management will have an overview of firm-wide risks and stresses and a concept of total risk even where precise aggregation is not possible.
- Senior management will consider formally the implications of stress testing for a firm's strategy or business profile.
- IT systems, resources and procedures will allow senior management to identify, quantify and manage efficiently the stresses that affect a group.

The key conclusions of the thematic review serve to validate the comprehensive approach. Specifically, good practice was seen where:

- (i) Senior management was engaged in the stress testing and scenario selection.
- (ii) Firms used stress tests of scenarios which were plausible, yet under which profitability was seriously challenged, key business-planning assumptions were flexed or scope for mitigating action was constrained.
- (iii) Firms communicate the results clearly and accessibly to the board.
- (iv) Stress testing and scenario analysis is done with a group-wide perspective.

It is very clear that under the new 'principles-based' regime the FSA is developing, senior management engagement and accountability is paramount. Points (i) and (iii) both refer to the board or senior management involvement; while all six of the characteristics of the comprehensive approach explicitly refer to 'senior management'. Additionally, the detail behind the points of good practice often refers to senior management input. For example, in point (i), the letter mentions

how good practice is to have a 'high-ranking' officer such as a chief risk officer take personal charge of the stress testing programme and reporting to senior management regarding its progress. Point (iv) also mentions that without a group-wide stress testing programme, senior management might not be able to assess the risks affecting their firm as effectively as they may want to in the absence of a group testing programme.

Firms may read this letter and think 'does this mean we need to do a review of all of the high-level risks to the business and flex our assumptions on them all?' or 'do we need to take a bottom-up view of all of our internal and external business risks and how they will affect our operations?' It is possible that one or both of these approaches may be correct for the individual firm, and therefore, according to principle-based regulation, different approaches by firms towards stress testing do not necessarily show an inconsistency of approach. The key here is the element of senior management engagement and involvement that should be applied to the work.

This 'Dear CEO' letter follows a trend in recent initiatives, with active involvement of senior management being central to good governance. This is also a characteristic of the FSA's approach to the Treating Customers Fairly (TCF) initiative, with similar senior management-based recommendations from the regulator. The FSA has also stated that it will be assessing firms' progress on both matters as part of their ARROW II visits.

When the stress testing/scenario-analysis challenges are combined with the upcoming deadline of March 2007 for progress on the implementation of TCF projects within firms, this puts an increasing burden on senior management in the current time horizon. Given that firms are not necessarily expected to have homogenous approaches to these initiatives, it therefore becomes important that senior management are able to have conversations within the board concerning their own approaches and how they are appropriate for their specific business model. It is clear that the stress testing initiative does matter to the FSA and firms have an opportunity to do some significant thinking about how to approach this. Our discussions across the market lead us to believe that, while doing nothing is typically not a practical option, there remains a real opportunity for firms to take the initiative and develop approaches that add value to the business as well as meeting the regulatory requirements.

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Due diligence on AIM IPOs

The London AIM market has become the international centre for IPOs of small to medium enterprises (SMEs).

In 2005 there were 311 IPOs on AIM (excluding investment companies) raising some £4.5bn; 72 of these were companies based outside the EU. The most popular countries were Australia, the United States, Canada and Israel. This trend has continued into 2006 with increasing interest from countries such as Russia and China. AIM is well established as an SME market with some 1,600 companies worth £75bn and is marketed as an exchange-regulated market outside of the main European regulation. Consequently it is seen as an easier market to join than the main London market or other international markets.

The London Stock Exchange has developed a regulatory framework which is based on the EU directive rules. It also requires AIM companies to have a Nominated Adviser (Nomad) at all times. The Nomad is responsible for ensuring the company is appropriate to be quoted on AIM and that the AIM rules are complied with. The Nomad carries out due diligence when the company first raises funds on the market and provides ongoing advice post IPO. Consequently the Nomad plays a critical role which is unique to the UK markets in vetting applicants. Some concerns have been raised as to whether adequate due diligence is being undertaken in all instances, particularly where the Nomad is based outside the UK and may not be so familiar with UK due diligence practices.

The more established UK-based Nomads tend to commission full due diligence from lawyers, reporting accountants and others as if the transaction was a full main market IPO. In reality, the level of work carried out is very similar, although there are often commercial pressures on professionals as the sums of money being raised are less. This level of due diligence may not be as extensive where

The more established UK-based Nomads tend to commission full due diligence from lawyers, reporting accountants and others as if the transaction was a full main market IPO.

the Nomad and reporting accountant are from outside the UK, and practice will vary depending on the level of UK input to the transaction. Potential investors should ask what level of due diligence has been done by the Nomad in bringing the company to market.

Part of the due diligence is knowing who the owners and management of the company are and what their background is. This can be difficult to establish for overseas companies and the Nomad will have to use his/her network to carry out checks before accepting the client. One obvious and surprisingly effective method is putting the names of individual owners, directors and the company into Google. This search engine is now so comprehensive that it has become quite useful for background checks. At the end of the day the Nomad has to meet the individuals, carry out checks and make a decision using his/her experience.

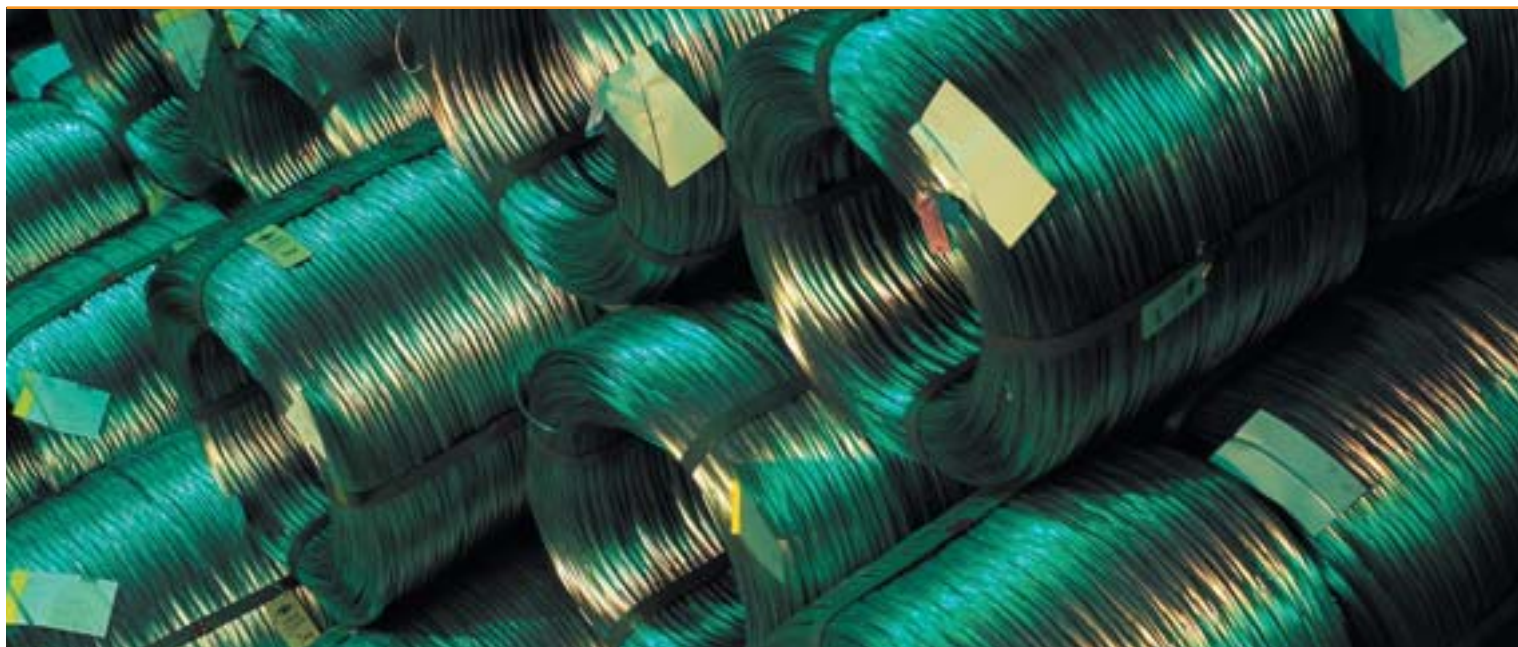
Many of the IPO transactions coming into London are in the form of global depositary receipts (GDRs) which tend to list on the main market but are not eligible for the market indices such as the FTSE. The GDR route is particularly popular for Russian companies. These transactions do not require a Sponsor or Nomad and the level of due diligence being carried out is typically less than for a main market or AIM flotation. For example the 'Long Form' due diligence report which is prepared by the reporting accountant is rarely commissioned for a GDR transaction. Retail investors do not tend to

invest in GDRs which are a wholesale market product.

In summary, investors need to understand the nature of the security they are investing in and the likely due diligence processes that will have been undertaken. They need to be alert to the political and other risks of the jurisdictions that the international company is coming from and to read the risk factors carefully. The experience and location of the advisers to the transaction is also a relevant factor to consider.

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Private equity: a new focus for FSA?



Early November saw the release of the FSA's long-awaited discussion paper on the private equity industry.

Despite the timing of its release, the discussion paper steered clear of lighting the touch-paper, describing the current regulatory approach to the private equity market as 'both proportionate and effective' while proposing enhancements to allow a more efficient response to developments within the market.

The review conducted prior to issuance of the paper is described as 'wide-ranging' and this is evident from the detail contained within it. The FSA has sought to ensure that, prior to any proposed change to the regulation surrounding private equity, its understanding of how the industry operates is sound. To this end, two of the six chapters cover in considerable detail the private equity market, its key players, the structures typically used, fee arrangements and incentive schemes adopted. Of the seven questions asked in the paper, three seek confirmation of their understanding and of the resultant identified risks.

The discussion paper considers each of the risks identified from the review and attaches a significance to them taking into account both impact and probability:

Significance	Risks
High	Market abuse, conflicts of interest
Medium high	Excessive leverage, unclear ownership of economic risk
Medium low	Market access, market opacity
Low	Reduction in overall capital market efficiency

The risk of market abuse within the sector focuses on the number of parties often involved in private equity transactions, both as advisers as well as principals, and suggests that the dissemination of information is less well controlled than it could be.

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The role of the banks in the private equity market permeates throughout the paper and in particular the risk assessment. Their role is discussed in detail within the assessment of conflicts of interest, excessive leverage and unclear ownership of economic risk. The risk of 'default of a large private equity-backed company or a cluster of smaller private equity-backed companies' is stated as inevitable 'given the current leverage levels and recent developments in the economic/credit cycle' and the FSA is clearly particularly concerned at the potential consequences for the banking sector.

Under the heading of market access and opacity, the paper considers the inherent constraints within the sector on retail and pension fund investment brought about through the lack of appropriate investment vehicles, the cash flow requirements, the lack of liquidity and the inconsistency of reporting. However, it does acknowledge that the level of reporting to existing private equity fund investors often provides more detail and insight than the public markets would require.

The risk of reduction in overall capital market efficiency notes the shrinkage in the size of the UK public market over recent years and cites the growth in public to private transactions financed by private equity houses as a contributing factor. This has been made ever more possible by the growth in new fund sizes (the 'mega funds') and the continued popularity of club deals.

In response to these perceived risks the FSA proposes some enhancements to the current 'light-touch' private equity regulatory regime. In most cases this is

centred around on-going monitoring of the risks identified through:

- Amendments to the financial reporting information submitted by private equity managers (which has historically been the same as for other asset managers). These include the addition of deal numbers and sizes as well as funds under management based on total commitments as opposed to drawn-down amounts; and
- Monitoring of the amount of leverage through repeats of the FSA's recent leveraged buy-out survey, potentially as frequently as every six months.

In addition, the paper announces the establishment of an alternative investments centre of excellence by bringing together the private equity and hedge fund supervisory teams. Throughout the paper comparisons are drawn with the hedge fund industry, although the FSA notes 'that the risks inherent in private equity are generally less significant than, for example, the risks found in the hedge fund sector', perhaps adding fuel to the arguments of those private equity participants who seek to distance their own market from the hedge fund sector.

Comments are requested by 6 March 2007, after which time such comments will be reviewed, and a Feedback Statement is anticipated for the summer of 2007. Industry participants should respond: this may be their best chance to influence the FSA's plans for this sector.

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Winter 2006: Technical round-up



This article contains reminders of regulatory developments which may be significant to some firms but are not covered in more detail elsewhere in this issue.

Prudential rules

The new prudential framework includes dedicated prudential sourcebooks for different categories of regulated firm subject to European directives, as follows:

GENPRU	General provisions
BIPRU	Banks, building societies and investment firms
INSPRU	Insurers
MIPRU	Mortgage and insurance intermediaries
UPRU	UCITS management companies

These sourcebooks come into force from 1 January 2007, with the exception of INSPRU and sections of GENPRU

applying to insurers only, which came into force on 31 December 2006.

Banks and investment businesses

Starting in August, the FSA has been sending 'Dear CEO' letters to firms giving some details of how the Capital Requirements Directive (CRD) will affect them. The final text of the new rules in GENPRU and BUPRU was published at the end of October. Progress has been summarised in CRD Implementation Bulletins in November. At the time of writing, some transitional provisions have not yet been finalised, but otherwise the CRD regime is now in place.

The Committee of European Banking Supervisors (CEBS) has announced that firms subject to the CRD can use recommendations from the top three credit-rating agencies for regulatory capital purposes. CEBS conducted a survey of the external credit assessments

from Fitch Ratings, Standard & Poor's Ratings Services and Moody's Investors Service to ensure they meet the requirements for External Credit Assessment Institutions (ECAIs) as set out in CRD. Participants (including the FSA) came to the 'shared view' that the three agencies should be deemed eligible. They also considered the mapping of ratings to risk weights. ECAI ratings can be used in both the Standardised Approach to credit risk and the Securitisation Ratings Based Approach.

Reporting

The FSA has published a policy statement concerning integrated regulatory reporting for CRD firms providing feedback on the comments received as a result of its consultation in May 2006.

The Companies Act has been amended to allow some 'small' non-ISD investment businesses to use the exemption from a statutory audit for years ending on or after 31 December 2006. The FSA has amended its rules so that these firms will also be exempt from the requirement to have their capital adequacy return audited. If such firms hold client money or custody assets, they will still require a regulatory audit of compliance with the CASS rules. This change is in addition to the existing exemption for investment businesses classified as 'small personal investment firms' and the forthcoming removal of the prudential audit of CRD firms for years ending after 31 December 2006. The FSA is carrying out a complete review of the use it makes of auditors to report on information about regulated firms and expects to publish further proposals next summer, when further changes in its approach may well be made.

Insurance

The FSA has been finalising all the building blocks for its new prudential regime implemented from the end of the year. The well-prepared insurer needs to

be aware of the changes introduced from that date. In particular:

- The restructured prudential sourcebook.
- The changes to life insurers' reserving and capital requirements.
- The new guidance on the Individual Capital Adequacy Standards (ICAS) framework applying to all life and non-life insurers.
- Minor changes to the Insurance Annual Return.

Life insurers are subject to a number of changes as discussed in the previous issue of UK Financial Services Regulatory Focus. In particular, the FSA has modified its requirements in order to move non-profits business to a more realistic basis, so extending the concept of economic realism to the prudential regulation of all life insurance firms.

This new guidance on the ICAS framework applying to all life and non-life insurers introduces a set of sub-principles and associated guidance that will provide firms with greater certainty about the FSA's expectations for ICAS submissions. This is important, as the FSA is placing increased reliance on ICAS as a risk-based measure of adequate capital and the financial resources that are realistically available to firms. Setting out the ICAS requirements more fully is intended to provide a useful reference point in the Solvency 2 negotiations. In particular, the UK is currently proposing that a similar principles-based framework be used to determine internal model requirements in Pillar 1 of Solvency 2. In addition, the ABI has made available further detailed guidance aimed at insurers.

Negotiations at a European level continue regarding the development of the Solvency 2 Directive, though the revised framework is not expected to be published until July 2007. Worries that Solvency 2 may require companies to hold excessive amounts of capital or may

make products more expensive for consumers have resulted in a paper being submitted to the European Commission by the Treasury and the FSA. This recommends that solvency requirements should be applied at group level rather than to each individual subsidiary. The paper also says that Solvency 2 needs to incentivise insurers to diversify risks at the level of an individual insurance company, but points out that many major insurers are organised as a group of companies and diversification effects can arise not only within each company but also across the companies in the group because of their different risk profiles.

Conduct of Business rules

Banking

In the banking sector, APACS, the UK payments association, has published Best Practice Guidelines 2006. The guidelines cover, *inter alia*, the credit card summary box, with the concept extended to credit card cheques. Meanwhile, the BBA has circulated proposals to amend the April 2003 version of the BBA/BSA Code for the Advertising of Interest Bearing Accounts. The changes are designed to reflect the increasing complexity of savings products.

The FSA has issued a 'Dear CEO' letter reporting on the results of a thematic review of stress testing practices at 10 large firms across the banking, building society and investment banking sectors. The letter sets out the key findings in relation to senior management with further details in a 12-page appendix. While some firms were regarded as strong against all the characteristics the FSA has identified, a small number were weak in all respects. The FSA notes that most firms are still developing and improving their practices. No new rules or guidance will be issued as a result of the exercise but once again the FSA has demonstrated the importance it places on stress testing.

The FSA has also issued a Business Continuity Management Practice Guide sharing the experiences of more than 60 firms which took part in the Resilience Benchmarking Project carried out by the Tripartite Authorities (FSA, HMT, BoE) in 2005. This looked at the resilience and recovery capabilities of the UK financial services sector in the event of major operational disruption. The Guide is based on the practices seen in the project and differentiates between leading practice and standard practice.

The Bank of England has issued a consultation document on plans to introduce a regular survey of UK loan market conditions to support its analysis of monetary conditions and financial stability. Similar surveys are already published by the Federal Reserve System in the U.S., the European Central Bank and the Bank of Japan.

Anti-money laundering

The EU Parliament has finally approved a regulation to implement the Financial Action Task Force (FATF) special recommendation 7 (dating from October 2001) requiring that detailed information about the sender be included in cross-border electronic transfers of funds. The regulation is likely to apply from 1 January 2007 although, acknowledging that banks will need time to alter systems, the related sanctions will not apply before 15 December 2007, which is the effective date for implementation of the 3rd Money Laundering Directive. Nonetheless institutions will be expected to take reasonable steps to implement

the requirements as soon as practicable. The EU requirement will apply to domestic as well as cross-border transfers. Guidance for banks will be published as part of the Joint Money Laundering Steering Group (JMLSG) Guidance Notes for the UK Financial Sector. Meanwhile, JMLSG has published a paper which assesses anti-money laundering and combating the financing of terrorism standards in other countries. This is the latest version of a paper which is updated periodically and which was formerly Appendix D in the old JMLSG Guidance Notes.

Also on the money laundering front, FATF has finally removed Myanmar from its list of non-cooperative countries and territories. There are no longer any territories on the NCCT list.

Investment businesses

The FSA has recently issued a policy statement arising from its consultation on regulation of home reversion plans and Islamic Ijara mortgages (home purchase plans).

In relation to soft commission and bundled brokerage, the FSA has published a survey of practices under the new regime and a consultation paper on the use of dealing commission (part of Quarterly CP No.10).

The FSA

The FSA has calculated its performance against various service standards for the first half of its 2006/7 year. One section of

its report explains whether it is achieving its targets of 'regulatory decisions, e.g.:

- The FSA aims to process 85% of applications for approved persons within seven working days and achieved this in 91% of cases.
- The target for giving waiver decisions was 85% within 20 business days and the FSA achieved 99%. However, this target will not apply to more complex CRD waivers.

Mystery shopping is a technique used by the FSA to assess levels of compliance. In November, the FSA published a guide on how it conducts mystery shopping.

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The Bank of England has issued a consultation document on plans to introduce a regular survey of UK loan market conditions to support its analysis of monetary conditions and financial stability. Similar surveys are already published by the Federal Reserve System in the U.S., the European Central Bank and the Bank of Japan.

European watch: bringing MiFID to life

The Committee of European Securities Regulators (CESR) has set out an ambitious work programme with the aim of making the Markets in Financial Instruments Directive (MiFID) operational.

From time to time this column has talked of the importance of the so-called Level 3 Committees. These are groups of supervisors which look to co-ordinate supervisory policy and practice across the EU and give practical reality to the principles and provisions set out in EU directives. There are three such committees, one for each of Securities, Banking and Insurance. In the long run, these committees will fundamentally shape the regulatory regime (and the cost of compliance), and so it is appropriate to focus on what CESR is up to, especially with the FSA's estimate of a £1bn price tag on MiFID implementation fresh in the mind.

With the end of the legislative phase of MiFID, CESR is shifting its priorities to tasks of an operational nature and, in particular, is looking to strengthen supervisory convergence. CESR is therefore looking to promote uniform implementation of the rules across the EU. This may turn out to be a mixed blessing, but nevertheless, the establishment of the MiFID work programme is the first step towards delivery of this objective.

This programme follows market consultation. Practitioners wanted CESR to prioritise work that clarifies the directive's impact on firms' processes and systems and work that has a direct impact on facilitating the cross-border provision of investment services and activities. CESR's 2007 MiFID work programme therefore includes developing guidance on, among other things:

- The operation of the EU passport and the relationship between home and host supervisors.

- Best execution – how this might apply in quote-driven markets and other practical issues.
- Record keeping and the minimum list of records to be kept.
- Outsourcing.
- Internal governance and the interaction between the Capital Requirements Directive (CRD) and MiFID.
- Clarification and practical implementation of provisions on inducements including softing and bundling.

This guidance will be developed through market consultation. The first consultative documents on record-keeping requirements and on market data publication were launched on the same day as the work programme. Further consultative documents will be issued throughout late 2006 and early 2007.

With the 1 November 2007 implementation deadline rapidly looming, CESR is looking to finalise this guidance by early spring to complement material already issued, for example by the FSA in the UK in CP 06/19 and CP 06/20, to assist practitioners in implementing MiFID. In view of the urgency, consultation periods are likely to be shortened from the usual three months – so practitioners and trade associations will need to be especially fleet of foot in the coming weeks if they wish to influence the debate.

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In the UK, we have a dedicated team of over 125 regulatory compliance specialists offering proactive regulatory advice to authorised firms and other financial institutions in the UK, within the EU and across the world. The group comprises teams of partners, directors, managers and staff, with extensive knowledge of regulatory rules, codes of conduct and prudential supervision, focusing on delivering particular solutions and products to certain sectors of the financial services industry. The team blends the experience of former senior regulators, compliance managers, industry personnel and staff with a broader industry/professional background. Our principal contacts are as follows:

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