**Introduction to financial services regulation in the UK**

This element introduces the regulatory framework in the UK in relation to financial services

**Financial Services Regulation in the UK**

The Financial Services Act 2012 (FSA 2012) came into force on 1 April 2013 and amended the Financial Services and Markets Act 2000 (FSMA 2000). The current financial regulatory structure is based primarily around:

- The Prudential Regulation Authority (“PRA”)

- The Financial Conduct Authority (“FCA”). Together the FCA and PRA (together the “Regulators”) replaced the Financial Services Authority on 1 April 2013 as the principal UK financial services regulators.

- The Financial Policy Committee (“FPC”) - Macro-prudential authority, within the Bank of England (“BoE”)

**The PRA**

The PRA is responsible for prudential regulation of institutions with the most significant potential impact on the stability of the UK economy (incl. banks, building societies, insurers and certain investment firms.) The PRA is responsible on a ‘micro’ level for promoting the safety and soundness of the firms which it regulates. ‘Prudential’ regulation can be contrasted with ‘conduct’ regulation. Put simply, the difference between conduct and prudential regulation is that regulation of conduct concerns the behaviour of firms and financial professionals whereas prudential regulation is a legal framework focused on the financial safety and stability of institutions and the broader financial system.

**The FCA**

The FCA is responsible for regulation of conduct in retail and wholesale financial markets and prudential regulation of firms which are not prudentially regulated by the PRA.

The FCA also regulates consumer credit and some financial benchmarks, ensures that listed companies meet their disclosure obligations, is the main competition regulator for the UK financial services markets with equivalent powers to the UK’s Competition & Markets Authority, and is one of the criminal prosecutors of market abuse, money laundering and fraud offences within the financial services sector.

Most UK financial firms are solely regulated by the FCA for both prudential and conduct purposes.

Some firms, (banks, insurers and major investment firms) are ‘dual regulated’: day-to-day operations are regulated and supervised by the FCA for conduct issues; and the PRA for prudential issues. The FCA and the PRA have different objectives and act separately but they coordinate internally to share information and data.

**The FPC**

The FPC is responsible for identifying, monitoring, and acting to remove or reduce systemic risks in order to protect and enhance the resilience of the UK financial system. Operates on a ‘macro’ level, steering the protection and enhancement of financial stability in the UK as a whole. It operates on a ‘macro’ level. The FPC is a committee of the Bank of England. It has an important role in the financial system as a whole but less of an impact in terms of direct regulation of firms.

**The “general prohibition”**

This part of the element focuses on regulated activities and the need for authorisation.

A person, which includes an individual or a firm, cannot carry out or purport to carry out a regulated activity in the UK unless they are either an authorised person (meaning that they have been given permission by the Regulators to carry on a regulated activity); or an exempt person (Section 19 FSMA 2000). Firms which are not authorised or exempt are therefore prohibited from carrying on any regulated activity in the UK. This is known as the "general prohibition". It is a criminal offence to carry on a regulated activity in breach of the general prohibition. (Section 23 FSMA 2000).

**“Regulated activities”**

A regulated activity is broadly defined as an activity of a specified kind which is carried on by way of business, and relates to a specified investment or property of any kind; or to information about a person's standing; the setting of a specified benchmark; or administering a benchmark. (Section 22(1)) and 22(1A) FSMA 2000). For many purposes, an activity of a 'specified' kind refers to those activities which are specified by an order of the Treasury; and specified as regulated activities in the FSMA 2000 (Regulated Activities) Order 2001 (SI 2001/544), (the “**Regulated Activities Order**”). An example of a regulated activity is providing advice to consumers on whether to invest in a particular financial product. However, the full range of activities is very wide, covering activities connected to banking, investment, consumer mortgages, insurance and insurance broking, consumer credit and more. All regulated activities are set out in detail in the Regulated Activities Order.

An authorised firm can only carry out regulated activities for which it has been given specific permission by the Regulators. Authorised firms are in principle subject to the Regulators’ rules and powers under FSMA 2000. Meanwhile, unauthorised firms are not generally subject to the Regulators’ rules or regulatory powers. However, there are some exceptions. For example, the FCA has powers to take action against any person whose behaviour constitutes market abuse, irrespective of whether or not they are authorised. (Part 8 FSMA 2000).

**Individuals**

The Regulators are responsible for regulating retail and investment banks, building societies, credit unions, investment firms and insurers (amongst others). However, they also regulate individuals.

The regime under which individuals are regulated is known as the Senior Managers and Certification Regime (“**SM&CR**”). In the period since March 2016, the SM&CR has superseded the pre-existing scheme for regulation of individuals and been extended in stages to different categories of firms and areas of activity with the purpose of raising standards of governance, increasing individual accountability and helping restore consumer confidence in the financial services sector. With only limited exceptions, the SM&CR now applies very broadly across individuals working in the financial services industries. This means that there are wide-ranging possibilities for the Regulators to exercise their powers against individuals, including, for example to take enforcement action against them if necessary and appropriate.

**FCA Objectives**

This part of the element focuses on the FCA as the sole regulator for most UK financial firms.

The FCA has a strategic objective to ensure that markets function well and three operational objectives. These comprise:

- The ‘Consumer Protection’ Objective, s. 1C, The consumer protection objective is: ‘securing an appropriate degree of protection for consumers’.

- The ‘Integrity’ Objective, s. 1D, The integrity objective is: ‘protecting and enhancing the integrity of the UK financial system’.

- The ‘Competition’ Objective, s. 1E, The competition objective is: ‘promoting effective competition in the interests of consumers in the markets’.

**FCA Handbook**

The FCA’s rules and Principles are contained in the very extensive FCA Handbook, which is supplemented by a series of regulatory guides. This is accessible online at the FCA website on www.handbook.fca.org.uk .

The FCA Principles for Businesses (the ‘Principles’) are 11 high level rules which apply to all FCA regulated firms. The Principles form part of the FCA’s High Level Standards set out in PRIN 2.1 of the FCA Handbook. The Principles set out the fundamental obligations of all FCA regulated firms, and provide the foundation for the other rules and guidance set out in the FCA Handbook. The Principles (at PRIN 2.1.1) are:

Principle 1 (integrity)

A firm must conduct its business with integrity.

Principle 2 (due skill, care and diligence)

A firm must conduct its business with due skill, care and diligence.

Principle 3 (management and control)

A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.

Principle 4 (financial prudence)

A firm must maintain adequate financial resources.

Principle 5 (market conduct)

A firm must observe proper standards of market conduct.

Principle 6 (customers’ interests)

A firm must pay due regard to the interests of its customers and treat them fairly.

Principle 7 (communications with clients)

A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.

Principle 8 (conflicts of interest)

A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.

Principle 9 (customers: relationships of trust)

A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment.

Principle 10 (clients’ assets)

A firm must arrange adequate protection for clients’ assets when it is responsible for them.

Principle 11 (relations with regulators)

Principle 11 requires a firm to deal with its regulators in an open and co-operative way. On this basis, firms must disclose to its regulators anything relating to the firm of which the regulators would reasonably expect notice.

Principle 12 (consumer duty)

A firm must act to deliver good outcomes for retail customers.

**Breach of the principles**

Breaches of the Principles may result in enforcement action being taken against a firm (PRIN 1.1.7G of the FCA Handbook). The Principles are deliberately expressed in very broad terms and therefore cover situations not foreseen by the detailed rules in the FCA Handbook. Therefore, breaches of the Principles may result in enforcement action being taken against a firm, even where the firm does not appear to have breached the detailed rules in the FCA’s Handbook.

Note that the PRA has Fundamental Principles equivalent to 1-4 and 11 (above) but in this element we are focusing on the FCA.

**Principle 11- relations with regulators**

Of all the FCA Principles and Rules, whilst Principle 1 is usually viewed as the most serious, and tends to attract more significant disciplinary consequences, the most frequently encountered in practice is Principle 11. This contains the basic reporting obligation owed by all regulated firms (and their employees who fall within SM&CR) to their Regulators. As can be seen above, the obligation is very wide: note in particular the wording of the requirement that “firms must disclose to its regulators anything relating to the firm of which the regulators would reasonably expect notice.” Principle 11 is also supplemented and supported by further rules and guidance in the Supervision Chapter (SUP) of the FCA Handbook, in particular SUP 15.

SUP 15.3.1 provides that a firm must notify the FCA immediately it becomes aware of any matter which could affect the firm's ability to continue to provide adequate services to its customers and which could result in serious detriment to a customer of the firm.

Breach of the extensive duties of disclosure is treated extremely seriously and may have a number of consequences.

**Consequences of breach of regulatory reporting duties**

- Effect on the Regulators’ approaches to their investigation(s)

- More likely that the Regulators will bring disciplinary proceedings for the original regulatory breach

- The firm and/or the individual may be liable to regulatory action for the failure to report

- Effect on the Regulators’ decisions about disciplinary penalty and other regulatory responses

- Risk of criminal liability for misleading the Regulators.

**COCON 2.1.3- Individual Conduct Rule 3 - Relations of individuals with regulators**

In the Handbook, the Individual Conduct Rules and the Senior Management Conduct Rules are set out in the Code of Conduct for Staff Sourcebook. This is a section within the FCA Handbook known as ‘COCON’.

The Individual Conduct Rules apply to all non-ancillary employees of a firm and require, amongst others, that individuals act with integrity; that they have due regard to the interests of consumers; and that they observe proper standards of market conduct. The Senior Manager Conduct Rules apply to a firm’s most senior management.

Individual Conduct Rule 3 (at COCON 2.1.3) reiterates for individuals the importance of the relationship with regulators as seen above in Principle 11. It states:

*“You must be open and cooperative with the FCA, the PRA and other regulators.” and Senior Manager Conduct Rule 4 (at COCON 2.2.4) states “You must disclose appropriately any information of which the FCA or PRA would reasonably expect notice.”*

**FCA Business standards**

The FCA Business Standards set out most of the more detailed conduct of business requirements which apply to all FCA regulated firms. This gives you an idea of the range of conduct rules imposed by the FCA. These include the Conduct of Business sourcebooks (‘COBS’) and other rules and guidance as summarised below.

COBS (Conduct of Business)

Sets out the conduct of business requirements applying to firms accepting deposits, conducting designated investment business and carrying on long-term insurance business in relation to life policies.

ICOBS (Insurance: Conduct of Business)

Sets out the conduct of business requirements which apply to the non-investment insurance business.

MCOB (Mortgages and Home Finance: Conduct of Business)

Sets out the conduct of business requirements applying to firms conducting regulated mortgage activities and home finance.

BCOBS (Banking: Conduct of business sourcebook)

Sets out the conduct of business requirements for firms that accept deposits from banking customers.

CASS (Client Assets)

Outlines rules and guidance on holding client assets and client money, including requirements as to segregation and safe custody of assets, statutory trusts in respect of client money, and retrieving information in the event of insolvency

MAR (Market Conduct)

Sets out rules and guidance of relevance primarily to the wholesale and professional markets.

**Summary**

- A person, which includes an individual or a firm, cannot carry out or purport to carry out specified activities in relation to financial services unless they are authorised by the Regulators to do so, or are exempt.

- Thee FCAs three objectives are (broadly) to protect consumers, protect and enhance the integrity of the UK financial system, and promote competition in the interests of consumers.

- Principle 11 of the FCA Principles for Businesses requires the firms to notify its regulators of anything relating to the firm of which they would reasonably expect notice.

- All non-ancillary employees of a firm must be open and cooperative with their regulators, and face a similar obligation to notify.

- A failure to notify a regulator as required can be a breach of the rules in itself and lead to disciplinary proceedings and potentially criminal liability.