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Dear Rory

6 April 2009

## **FSA Consultation Paper CP08/24: Stress and Scenario Testing (the Consultation Paper)**

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### **1. THE CITY OF LONDON LAW SOCIETY**

The City of London Law Society ("CLLS") represents approximately 13,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees. This response to FSA CP08/24 (Stress and Scenario Testing) has been prepared by the CLLS Regulatory Committee. Members of the CLLS Regulatory Committee (the **Committee**) advise a wide range of firms in the financial markets including banks, brokers, investment advisers, investment managers, custodians, private equity and other specialist fund managers as well as market infrastructure providers such as the operators of trading, clearing and settlement systems.

### **2. RESPONSE TO THE CONSULTATION PAPER**

The Committee does not take it upon itself to comment on any policy aspects of the Consultation Paper. Rather, our concern is to ensure that the obligations which would be imposed on firms, the standards of behaviour FSA would expect firms to meet and the likely steps which will be followed by FSA, each in conjunction with the matters discussed in the Consultation Paper, are clear and certain.

## 2.1 First-to-market regulation

We refer to our response to the FSA's Consultation Paper 08/22 titled "Strengthening Liquidity Standards" dated 13 March 2009. A number of concerns raised therein, particularly in relation to the FSA taking a "first to market" approach to regulation, apply equally in the context of the Consultation Paper.

In addition, we note that the FSA's General Prudential Sourcebook (**GENPRU**) and Prudential Sourcebook for Banks, Buildings Societies and Investment Firms (**BIPRU**) are currently based on the Capital Requirements Directive, which in turn applies the Basel Committee's Basel II Framework. Any departure from these rules which does not implement amendments to the Basel II Framework or the Capital Requirements Directive will cause questions of interpretation and interoperability, not to mention an increased compliance burden – both because cross-border firms will need to be compliant with multiple systems and rules, but also because it is likely that future changes to the Capital Requirements Directive will necessitate further changes to both GENPRU and BIPRU.

## 2.2 Application to small firms

Paragraph 3.28, and the proposed text of SYSC 19.1.1, confirms that BIPRU 50K investment firms with less than £1 billion of funds under management (**excluded BIPRU 50K firms**) will be outside of the scope of the reverse stress testing requirements. We agree with FSA's comments that compliance costs are not always fully scalable for such firms and with the position that such firms should be excluded. However, paragraph 3.30 suggests that excluded BIPRU 50K investment firms should consider conducting reverse stress tests anyway; this appears to be reinforced by the content of Annex 2 to the Consultation Paper. We are concerned that the guidance may give FSA cause to require such firms to conduct reverse stress tests in practice, but without providing such firms with the benefit of defined Rules; in other words, the content of the Consultation Paper creates a lack of certainty for excluded BIPRU 50K firms.

If FSA has particular requirements as regards the stress tests to be conducted by excluded BIPRU 50K firms, anything less than the implementation of a Rule might be seen as an attempt to circumnavigate the procedures and formalities which must otherwise be followed. We would therefore argue that it must either be clear that there is no requirement or that the nature of the requirements should be set out in a Rule and thereby made binding on firms or at least be the subject of more expansive guidance, but in either case the procedures and formalities of consultation must be followed.

## 2.3 Industry forum

We would welcome the introduction of a regular industry forum, as proposed in paragraph 3.11 of the Consultation Paper. However, it is unclear what status would be held by the forum's findings. If the intention is that the forum's views as to the types of stresses that should be considered by firms is binding on firms, we reiterate our comments in section 2.2 above and suggest that FSA should introduce a proper process for ensuring that those views are implemented as Rules. Alternatively, if the forum's purpose is merely to inform guidance which firms may choose to follow, thought should be given to the manner in which the forum's output is disseminated, collated and made accessible, so as to ensure that such guidance is easy to

find and follow at all times. In addition, the forum would need to be constituted so as to represent the full range of affected firms.

We would welcome further dialogue with FSA in connection with the Paper and, specifically, the matters raised above.

Yours sincerely

**Margaret Chamberlain**  
**Chair CLLS Regulatory Committee**

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