



**Consumer
Focus**
Campaigning for a fair deal

Consumer Focus response to HMT consultation on a new approach to financial regulation: building a stronger system

April 2011

About Consumer Focus

Consumer Focus is the statutory consumer champion for England, Wales, Scotland and (for postal consumers) Northern Ireland.

We operate across the whole of the economy, persuading businesses, public services and policy-makers to put consumers at the heart of what they do.

Consumer Focus tackles the issues that matter to consumers, and aims to give people a stronger voice. We don't just draw attention to problems – we work with consumers and with a range of organisations to champion creative solutions that make a difference to consumers' lives.

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A new approach to financial regulation: building a stronger system

Overview

Consumer Focus welcomes this consultation on the new regulatory structure. Our response is mainly concentrated on the role of the Financial Conduct Authority (FCA) and its relationship with the Prudential Regulation Authority (PRA), Financial Ombudsman Service (FOS), Consumer Panel and Money Advice Service. We are encouraged by our analysis of the proposals on objectives and powers of the proposed new regulator but strongly believe there are areas where consumer protection will need to be further strengthened.

The proposed changes will require a complete culture change from the regulator, and new skills and ways of thinking. It is important that the foundations for culture change are laid early to provide industry and consumers with a clear statement that this is not the same body with a new set of clothes.

The concurrent consultations on simple products and on product intervention along with the proposed transfer of the Consumer Credit regime to the FCA also have the potential to lead to far-reaching changes to consumer protection.

As Mervyn King recently noted banks exploit ‘gullible or unsuspecting’ customers.¹ We do not support unnecessary regulation, as this is not in the consumer interest. However, in financial services, it is not helpful to talk about regulation as a ‘burden’, given that the case for intervention here is to:

- correct substantial market failure
- provide safeguards against any repetition of past industry irresponsibility
- remedy a significant imbalance of power between industry and consumer

Our experience is that effective regulation will promote a better market place with more efficient product and service provision. We do not want to see the continued emergence of regular misselling scandals or unsafe practices involving high consumer detriment and huge numbers of complaints to the FOS. As Adair Turner comments in the FSA Annual Report, 2009/10, ‘this periodic process of large scale customer detriment and then customer compensation is not an acceptable or sensible model for the future.’

The current system rewards inefficiency and entrenches advantage instead of supporting the stability of the market and the interests of consumers. It is vital that, under the changed regulatory structure, new entrants and those who are more flexible and better able to respond to consumers’ needs are able to flourish. The fact it is proposed that the FCA should have a duty to use competition as a tool to promote consumer protection will prove helpful in this respect.

¹ Mervyn King: *Bankers exploit gullible borrowers to pay for their bonuses* on [gurardian.co.uk: http://bit.ly/fzTUbc](http://bit.ly/fzTUbc)

Financial Policy Committee

1. What are your views on the likely effectiveness and impact of these instruments as macro-prudential tools?
2. Are there any other macro-prudential tools which you believe the interim FPC and the Government should consider?

We agree that, if the Financial Policy Committee (FPC) has the objective of contributing to the 'Financial Stability Objective' of the Bank of England ('the Bank'), it should have the tools to do so effectively. However, as the Treasury Select Committee (TSC) points out, 'many macro-prudential tools are only now being developed, and their effectiveness will need to be monitored'.² The potential impact on consumers must be a key consideration in relation to the FPC's proposed use of any macro-prudential tools.

In *Feast to famine*³ by the Financial Inclusion Centre (commissioned by Consumer Focus), counter-cyclical capital requirements were suggested as a potential prudential tool, which would enable regulators to encourage lending during an economic downturn and rein in lending during a credit boom.

In terms of weighting capital requirements differently according to risk, as the paper recognises, the correct identification of risk is not a straightforward task. We are committed to promoting diversity in the market and would be concerned if increasing capital requirements on institutions that are considered risky created greater barriers to those institutions that are genuinely offering different models of financial services, which could benefit consumers.

The recent interim report⁴ from the Independent Commission on Banking (ICB) noted the subsidy to the banking sector was significant and well in excess of £10 billion as a result of the implicit state subsidy reducing the cost of borrowing. The report also noted the larger the bank the larger the subsidy. Therefore, in order to create diversity the FPC will need to reflect not just on safety and risk but also the need to ensure a diversity of offerings, fair competition between larger and smaller banks and effective consumer choice.

Finally, the nature of the tools is important, but the willingness to use them in appropriate circumstances and the manner of execution will determine their effectiveness and impact.

3. Do you have any general comments on the proposed role, governance and accountability mechanisms of the Financial Policy Committee?

Our concern with the placement of the FPC and PRA in the Bank of England is that central banks have never been particularly open or transparent about their operations. There need to be robust mechanisms in place to ensure transparency and a high degree of accountability in relation to the FPC.

Furthermore, the membership of the FPC is weighted in favour of the Bank of England. While the paper acknowledges the importance of the 'non-Bank members' in terms of contributing their experience and views, we are concerned that the impact of these contributions will be compromised by the Bank's dominance within the FPC. Increasing the influence of external members on the FPC would have the added benefit of

² Financial Regulation: a preliminary consideration of the Government's proposals, Treasury Select Committee, February 2011, page 26

³ Financial Inclusion Centre, *Feast to famine*, April 2009

⁴ Independent Commission on Banking Report April Interim 11 2011

counteracting the perception of the Bank as an ‘advocate of City interests within the Government’⁵.

We support the financial regulatory system having access to a wide variety of skills and knowledge to ensure its effectiveness for consumers. This should be the case for all of the regulators within the new system. However, it is envisaged that the four independent members of the FPC will have ‘direct experience as financial market practitioners’. Thus the FPC is entirely made up of financial industry representatives. We believe that the independent membership of the FPC should be broadened out to include those with consumer, economic, public policy and other relevant experience.

Prudential Regulation Authority

Questions 5 to 10

Strategic and operational objectives proposed for the PRA

We agree that ensuring the stability of the UK’s financial system is an important goal. In order to plan for their futures and participate in both society and the market place consumers need to have confidence that their savings and investments are safe and that credit is available both for themselves and for the companies that provide them with goods and services. Consumers as taxpayers also need to have the confidence that the wider economy will develop sustainably rather than be subject to cycles of boom and bust or, worse, hit with the recessionary fall out of full scale banking crisis and bailout.

However it is possible to have stability but at the same time to have a system that serves consumers poorly in terms of the choice and quality of the financial products available to them.

In this context, the goal of the FCA to protect consumers may come into conflict with the PRA’s objective for stability which could, at least in theory, mean that toxic products or misselling are not addressed where the practices are so entrenched or widespread that the costs of correcting behaviour are deemed too risky for overall stability.

Given the waves of misselling outlined in the FSA’s product intervention paper there is a real possibility of such practices occurring again. The new regulator should be equipped so as to have the ability to both identify and address the detriment at an early stage. However in circumstances where the early intervention does not occur, later action will be necessary and a veto by the PRA on FCA action could lead to consumer harm.

We note that the Government is not proposing the PRA should have regard to the objectives of the FCA and vice versa and is instead proposing that there be a general duty to co-ordinate and consult each other on views. In such a model an effective relationship between the two organisations is vital to avoid conflict or paralysis. A formal mechanism for co-ordination and conflict resolution needs to be put in place at the outset of the new structure.

We have stated above our concerns regarding the PRA being placed with the Bank. The paper justifies bringing the PRA within the Bank on the basis that it will lead to ‘improved co-ordination and harmonised action’ between the PRA and the Bank. Our concern is that, being a subsidiary of the Bank may compromise the independence, transparency and accountability of the PRA in relation to its own micro-prudential remit. The potential for such issues to arise is evident from the fact that the executive members of the PRA board will largely be made up of Bank officers and the Bank will retain full responsibility

⁵ John Kay in *The new financial services leviathan: has competition been a casualty of the financial crisis*, in Consumer Focus, *Rethinking Financial Services*, June 2010

for the appointment of members to the PRA Board. We would expect to see detailed proposals setting out clearly how it is proposed that the potential difficulties would be avoided. It is disappointing therefore that the consultation paper remains somewhat vague in this regard.

We also consider that there should be a diverse representation of consumer, public policy, regulatory, economic and industry expertise across the regulatory regime, including in respect of the PRA.

Accountability

The consultation paper sets out a number of welcome ways in which the PRA should be held accountable. We would add an obligation for the PRA to be required to explain why it has had to resort to any veto on an intervention by the FCA. A veto of an intended action by the FCA implies the likelihood of regulatory failure, by either the FCA or PRA or both, to take prompt corrective action to curb practices or products before they threaten stability. We talk more about the veto later on in this response.

Engagement

The scope for engagement by the PRA with consumers is limited to the ability for the wider public to comment on its annual report and the extent to which it has met its objectives. We doubt the extent to which this measure can provide a broad consumer perspective and in that light urge the Government to take a more directive approach to ensuring genuine engagement. Part of a solution would involve the Government reconsidering its decision not to allow the PRA to engage with the consumer panel more directly. The PRA should also invite representatives from consumer groups such as Which?, Citizens Advice and charities that have an interest in financial matters (Age UK, Shelter etc) to regular working groups to assess the impact of the PRA's decisions on the groups they represent. Other models for engagement involve the PRA meeting regularly with consumers at public events and publishing regular updates on key decisions and challenges throughout the year.

Financial Conduct Authority

11. What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the Financial Conduct Authority (FCA)?

Strategic and operational objectives for the FCA

The FCA's stated 'core purpose' of 'protecting and enhancing the confidence of all consumers of financial services' is very much welcomed and we are pleased that it is now said to have consumer interests at the heart of its regulatory approach. We do not consider, however, that the FCA as envisaged will also be a 'consumer champion', which would indicate a campaigning and lobbying role on behalf of consumers.

The single strategic objective of the FCA is 'protecting and enhancing confidence in the UK financial system'. Financial stability is fundamental to consumers in terms of the provision of low-risk sustainable products and services. Consumer protection is an essential part of that financial stability. However, it is not inevitable that consumer interests and protecting confidence in the financial system will always coincide. For example, if the survival of a firm or firms were dependent on a prevailing business model that would be curtailed by consumer protection measures, then the objective, as currently worded, could mean consumers suffered for the sake of protection of confidence in the system. Hence, we consider consumer protection should be one of the FCA's strategic objectives.

The FCA has three operational objectives, none of which are given priority, although it is evident that there may be conflicts between them. For example, it is stated that ‘removing regulatory barriers’ in order to stimulate competition is part of ‘facilitating efficiency and choice in the market’. It is evident that these measures will have to be balanced with ‘an appropriate degree of consumer protection’. It is not clear which objective will be given priority should they come into conflict. We do not oppose efficiency and choice in financial services, nor do we oppose the removal of unnecessary regulation, but this should not be at the expense of consumers or consumer protection. Hence we consider that of the three operational objectives, consumer protection should be given the highest priority if Government decides not to make consumer protection a strategic objective.

Securing consumer protection is a welcome operational objective, but we are concerned about it being qualified by the term ‘appropriate’. It is a qualification that is absent from either of the other operational objectives and we are concerned that this might lead to it being given lesser priority. In the consultation paper, the use of the term ‘appropriate’ is said to relate to the level of protection afforded depending on whether the consumer is a retail customer or a professional market participant. However, the objective is expressed in such general terms, that the use of ‘appropriate’ in this context gives us some cause for unease.

Competition

We note that by requiring the FCA to discharge its functions in a way that promotes competition, these proposals put a greater emphasis on promotion of competition than the previous ‘have regard’ approach under the Financial Services and Markets Act (FSMA). We welcome this recognition of how important competition is in ensuring well-functioning markets.

As the FSA has recently pointed out ‘...ineffective competition in retail financial services markets more usually results from a number of “demand-side weaknesses”. By this we mean that customers are not exerting pressure on firms to produce the desired quality of products or to influence prices’.⁶ Consequently, it is difficult for market forces alone to provide the type of market dynamic needed. We welcome and support the ICB recent recommendations to improve switching⁷.

Few consumers switch providers in financial services – our research found only 7 per cent switched personal current accounts (PCAs) over two years.⁸ Most buy other financial products from the same provider as their PCA.

However competition is a means to an end and so should not take priority over other regulatory principles. Competition should be a mechanism to deliver outcomes for users. The value of competition in achieving positive outcomes for consumers must be monitored on an ongoing basis and, if outcomes are not being achieved, measures must be taken in relation to competition to ensure a rebalancing towards consumer interests. As part of this process, there should be a greater role for stakeholders, including consumers and consumer groups, to raise competition issues in relation to financial services.

The danger of competition as a goal of the regulator is that the regulator moves into the role of promoting the industry. We welcome the proposal that the FCA will not be expected to promote competition where it is not compatible with its strategic or operational objectives. A stronger guarantee for consumers would be if consumer protection was promoted to a second strategic objective.

⁶ FSA Product Intervention DP February 2011

⁷ Independent Commission on Banking Interim Report 11th April 2011

⁸ Consumer Focus, *Stick or twist*, 2010; OFT, Personal Current Accounts – A Market Study

Regulatory principles

We are in broad agreement with the regulatory principles proposed, but raise a few specific issues below. It is also fundamental to their effectiveness that these principles are implemented on the basis of broader evidence and transparent decision-making.

‘Efficiency’: There is a danger that consideration of the need to use resources in the most efficient and economic way is interpreted in such a way that it constitutes a restraint on exercising powers.

‘Proportionality’: Consideration of the burdens or restrictions imposed must not be conducted in isolation of the benefits or in underestimation of benefits that are either difficult to quantify or where the advocates of those benefits are less well-resourced and influential than others, who are more forcefully represented.

‘Consumers are responsible for their decisions’: It is a truism that consumers are responsible for their decisions. The detriment suffered by many consumers, only some of whom have ever sought or received redress, shows they are responsible and indeed suffer the consequences when things go wrong. No regulatory protection is ever going to remove consumer responsibility but regulation must ensure that when consumers face a choice the information provided enable them to find suitable products that offer fair value and predictable quality. Across a whole range of financial markets this simply is not the case. Consequently this reference to consumer responsibility appears tokenistic and largely irrelevant. We would expect the regulator to tailor their regulatory approach to ensure that the balance of responsibility lay with the industry in relation to retail customers. Previous misselling scandals have indicated that consumers are at a considerable disadvantage when dealing with the financial services industry in terms both of complexity of products on offer, the fact that detriment may take many years to crystallise and the ability of banks to design products around consumer’s behavioural biases. Steps to improve the financial capability of consumers are welcome, but they are unlikely to change the power imbalance between the retail consumer and financial services provider and should not be seen in that light.

‘Transparency’: We are very supportive of improving the transparency of the regulator, particularly with regard to improved consumer engagement. We give further comments in respect of transparency as a regulatory tool below.

We strongly urge the Government to reconsider its decision to remove the promotion of financial inclusion as a ‘have regard’. While we agree that financial inclusion is also a social policy issue we believe that the mainstream financial institutions have a key role to play in relation to improving financial inclusion in the UK. The regulator would be in a prime position to ensure that their policies and procedures did not exclude those on low incomes or groups of consumers made vulnerable or at a disadvantage due to disability for example.

In the earlier consultation on regulatory reform we also proposed that there should be a wider public interest ‘have regard’, incorporating issues of public understanding and essential service provision as well as financial inclusion. It is disappointing to note that this has been rejected.

12. What are your views on the Government’s proposed arrangements for governance and accountability of the FCA?

The board of the FCA must contain a wide variety of knowledge and skills. Consumer expertise must be represented on the board as well as public policy, regulatory, economic and industry expertise and experience.

In principle, the veto the PRA has on FCA intervention and policy indicates to us that the FCA will be considered a subordinate body to the PRA and hence conduct and consumer protection issues will take second place to prudential regulation under the new regulatory regime. The FCA must have sufficient tools, independence and powers to properly carry out its consumer protection functions, and it should not be on a lesser footing than the PRA.

We are supportive of the continuation of the Consumer Panel. However, we are concerned about the lack of consumer engagement proposed under the new arrangements for the FCA. We have previously been critical of the FSA for a failure to engage effectively with consumers, and, despite recent improvements in seeking out consumer views (eg roundtables with public interest groups and charities), more needs to be done in this regard in the future. Without such an approach responses to consultations will continue to be dominated by responses from industry and its representatives.

The FCA needs to engage and provide real opportunities for consumers to contribute to its work. Its engagement strategy should provide:

- Opportunities to engage in the FCA's corporate planning processes to allow consumers to help shape the priorities of the Authority
- A 'consumer radar' of emerging issues and areas of detriment
- The ability to work both with representative bodies and directly with consumers themselves

In our report *Rating Regulators*⁹ we found evidence of good practice in engaging with consumers which the Government could consider in relation to the FCA. The Food Standards Agency, for a example could act a model for the FCA on engagement as a strong consumer-focused culture exists across the organisation. The Food Standards Agency is transparent about its activities (holding many meetings in public and having a culture with a presumption publication of documents and decision) and has well rated consumer engagement programme. Similarly the Communications Consumer Panel developed a Consumer Interest Toolkit to guide their involvement with customers of services in their sector.

Approach to conduct regulation

The FCA will be the conduct regulator for all financial institutions, but will also have prudential regulation responsibility for 18,500 firms that are not within the scope of the PRA. In due course, if the Treasury's proposals in this regard are implemented, it will have responsibility for all of the 96,000 consumer credit businesses currently regulated by the Office of Fair Trading (OFT). Thus, the proposed separation between prudential and conduct regulation of the financial services market will be only partially achieved. At the same time, the dual regulation of some firms presents a complex picture. This could give rise to confusion in terms of the responsibilities of regulators and may also prove difficult for consumers to navigate.

We are pleased to see that there will be a more proactive and interventionist approach on the part of the regulator and that, furthermore, 'the prevention of consumer detriment' will be central to its regulatory model. The new conduct approach will require a complete culture change from the regulator and involve new skills and ways of thinking. It is essential that this culture change is embedded in the foundations of the new regulator otherwise it will fail to meet its stated objectives. The specific regulatory tools and powers referred to below are examples of how the FCA will be enabled to be a more 'hands-on' regulator. In order to establish its credibility, it will be vital for the new regulator to demonstrate its commitment to this new conduct approach through its supervisory

⁹ Rating Regulators Consumer Focus 2009

measures and enforcement action. There will otherwise be a risk that it will be seen simply as the same body in a new suit of clothes and will lose public confidence as a result.

A more proactive regime which will also encompass consumer credit businesses is likely to be highly resource intensive and very different to the current consumer credit licensing carried out by the OFT. The paper does not explain how this will be funded. We are concerned that an increase in fees will be passed on to consumers and will also prove prohibitive to smaller consumer credit businesses and may put them out of business. This could present a significant barrier to new entrants, including community-based initiatives.

13. Views on proposed new product intervention power

We welcome the new product intervention powers and discuss our views in more detail in our forthcoming response to the FSA discussion paper on this topic.

We particularly welcome the move to legislate to make provision on the unenforceability of contracts made in breach of its product intervention rules making such contracts void.

It must be clear to both regulators and industry how the new powers on product intervention can be used.

We would be concerned if the evidence burden to justify action remains as high and as narrow as it has historically been, and where consumer input has been so ignored in the past. We would call for a differing approach to evidence in product intervention than has been the case for firm-specific enforcement action for breaches to their duties under FSA licensing.

If judgements on product design are going to be under a criminal level of proof, it is likely any such judgements will take a long time, since the FSA will have to be assured it has undertaken due diligence. Equally, it will have to prove it has gone through each of the product governance obligations, systems and controls before it makes any recommendation to intervene in product design. Finally, any use of extreme measures such as bans are likely to come in place once all other measures have been tried and once changes to governance processes explored. All the while, consumer detriment may well be accruing.

There are some specific examples of where we believe the high evidence threshold has prevented the FSA from being able to act in the consumer interest. We are aware that the FSA does not undertake extensive mystery shopping. Our understanding is that this is because the scale of the exercise necessary for such work to inform enforcement or monitoring activity would be so large as to be prohibitively expensive.

Equally, it appears the FSA cannot invoke consumer groups' or non-governmental organisations' use of mystery shopping or extensive anecdotal information as hard evidence. Clearly anecdotal information or consumer group information must require further analysis and substantiating evidence but the experience of consumer groups and consumers is that such information has roundly been ignored in the past rather than providing the basis for investigation.

As it stands, it appears the proof burden necessary for evidence to be taken into account is far too rigid, exclusive and narrow. The Government may wish to reflect on how far the FSA's rigid definitions of evidence go to explain its self-confessed reputation for appearing remote from the consumer before the crisis, and also why the FSA was incapable of foreseeing and preventing the crisis developing.

Consequently, we would like to see a greater level of detail about the nature of how such judgements will be reached. We believe this to be critical in terms of the efficacy of 'early

intervention'. In any new approach to product design, the regulator's ability to act depends on the burden of proof used in its risk matrix and what steps it must fulfil before using strong tools. We believe there is a significant risk the FCA may get caught up in process rather than acting quickly to prevent problems occurring as rapidly as it should.

The FSA has devoted significant resources into complaint handling as part of its Consumer Protection strategy and Financial Risk Outlook, both in 2010. They identified complaint handling as an area of significant detriment and likely resource reduction as firms looked to shore up their capital base. In order to prove the scale of the detriment the FSA looked at a significant number of files of the major banks and insurers to make an assessment of their complaint handling. Following that exercise, the FSA has undertaken a thorough work plan around improving complaint handling, redress, mass claims, enforcement for breaches to its DISP, and how complaint handling can feed into regulation. The work taken to discover firms' poor practices was quite clearly extensive.

It is quite unlikely the FCA will have the necessary resources to be able to devote to each product to investigate whether there needs to be early intervention.

The analysis that proved poor complaint handling was based on historic evidence – on complaint files, recorded timelines and advice. Judgements made on the basis of predicting and preventing detriment are clearly less empirical. In financial services, detriment may only be revealed well into the product life cycle and, in addition, a product may be toxic for some customers but not others. If the evidence burden were to remain as high then it is likely the process would be too long and acceptable evidence too narrow to deliberate on important factors that the FCA should use to inform its judgement. This will be particularly difficult considering the FCA's expanded work plan.

We would like clarification on consumer and consumer groups' involvement in the provision of evidence, and what matrix will be used. We believe there is the dual danger of the FCA's resources being tied up in proving governance processes cannot be first amended to remedy the problem and also in firms' gaming these measures, thus we could see large resources could committed for little return.

We do not believe product intervention as currently framed is likely to restore consumer confidence in the regulator since we do not believe it will be sufficient to make products suitable. We believe more forceful and preventative measures are necessary to restore trust.

We would like to propose a radical alteration from the discussion paper. The product intervention paper is quite explicit – the FSA does not plan to give product pre-approval. It identifies significant dangers in that approach. For the regulator it would be too resource intensive. There are dangers in giving products an FSA seal of approval and it may not be best placed to design products.

All the above makes the case for a separate mechanism to ensure consumer products have been pre-tested to remove any toxicity. Consumer Focus recently produced a discussion paper in association with the National Consumer Federation to look at how best products and services could be designed regulated and monitored to ensure customers are treated fairly and market competition leads to productive competition.¹⁰ This paper identifies how a framework of principles-based regulation can work alongside specific product steering groups to produce standards.

The paper borrows concepts that are used in product design from manufacturing and service delivery industries. It also allows consumers and consumer groups across the country to input into both the design and enforcement of standards. Flexible working

¹⁰ Consumer Focus, Fair enough <http://consumerfocus.org.uk/g/4ox>

groups could also adapt how the principles of fairness apply over time as market dynamics and technology evolves.

This could be done with an FCA approved standards committee for differing products. On such committees consumers and consumer groups could play some role in defining what is an acceptable and fair product in each market place prior to the FSA intervening. This could restore consumer trust and bring confidence in the regulator by enforcement directly being linked to consumer's expressed concerns.

If the focus was transferred to the end result – the product – it would save firms huge sums in compliance costs. Secondly, if product design intervention through standards preceded the regulator's intervention it would ensure appropriate products were designed with clear guidance to the regulator about what product was acceptable.

14. The Government would welcome specific comments on:

- the proposed approach to the FCA using transparency and disclosure as a regulatory tool
- the proposed new power in relation to financial promotions
- the proposed new power in relation to warning notices

Transparency and disclosure: Transparency will be essential for the FCA in the exercise of its functions. Consumer confidence as well as consumer protection is enhanced by the openness of the regulator. The regulator should be open in its investigations and regulatory activity and therefore accountable. Reputational regulation may, in itself, help develop a trusted brand approach in the industry. We have previously been highly critical of the FSA's opinion that they are unable to disclose early information about enforcement action and the compliance records of firms. Therefore, we very much support the Government's proposals to legislate to give the FCA additional powers of disclosure, which we hope will resolve this issue. A culture of publishing and analysing compliance, complaints and enforcement actions to identify emerging risk and as a window on the industry is vital. It is also central to developing a wider understanding of the role of the regulator.

It is important that the FCA provides consumers with usable information on numbers of complaints made to banks about their products and service. For the six month reporting period of January to June 2010, consumers of financial products and services made 1.8 million complaints¹¹.

The FSA and FOS are rightly trying to improve consumers' understanding of which firms are committed to giving good customer service by publishing complaints data.

We hope complaints data can become a productive way to differentiate brands. Complaints data can give consumers an informed opinion about which firms are customer service orientated, trustworthy and able to deal with complaints effectively.

It is early days in the publication of complaints data as part of the FSA's approach of transparency as a regulatory tool. Currently we have certain difficulties with the publication of the data, most notably the data:

- does not differentiate between banking products (within the banking and credit category);
- gives no indication of market share so it is difficult to assess how good or bad the bank is proportionately to their customer base

¹¹ <http://www.consumerfocus.org.uk/news/consumer-focus-response-to-fsa-complaints-published-today>

- fails to capture complaints resolved at 4 weeks
- fails to show how many complaints are resolved within the end of the business day

This aspect of qualitative assessment, based on brands actual performance in generating/avoiding complaints on specific products can be enhanced greatly.

We are unclear whether changes to the Financial Services and Markets Act would be necessary to enact such changes. In the interests of consumer empowerment any necessary legislation should be enacted to facilitate customer choice so that consumers can discipline the market by being able to make judgements of a firms' commitment to complaint handling and customer service.

Financial promotions: We support the FCA's new power to direct a firm to withdraw or amend misleading financial promotions with immediate effect and to publish that it has done so. This will reduce the potential consumer detriment as a result of such promotions and improve consumer confidence in the ability of the FCA to take effective action in appropriate circumstances.

Warning notices: This represents a key change in approach on the part of the regulator. As stated above, this is an area where the FSA has refused to provide any information in the past. We are very supportive of this strengthening of the current position, but note that it will not be a duty, but rather an expectation to be exercised at the discretion of the regulator. While we appreciate the need for fairness towards affected firms and individuals, the regulator should balance the impact on the subject of the notice with the potential detriment to consumers. In these situations, the consumer interest should take priority. Accordingly, there should be a regulatory presumption for the publication of a warning notice, apart from in exceptional circumstances specified within the legislation. Furthermore, where enforcement action has been upheld and no warning notice was published, an explanation of why the regulator exercised their discretion not to publish the notice should be provided. In addition, if it is decided at the outset of enforcement proceedings that the warning notice should not be made public, there should be an ongoing duty to continue to weigh the firm or individual's interests against those of consumers with regard to public notification of the enforcement process.

15. Additional powers in relation to general competition law

It is important that market failure is addressed promptly by the regulator and the current model of prompt analysis and recommendation provided by the super-complaint process operated by the OFT should be extended to the FCA. Power to bring a super-complaint to the FCA should be granted not only to the Consumer Panel but also other bodies such as our successor body Citizens' Advice and Which?.

The Consumer Panel would benefit from powers to request information from providers in order to carry out its statutory functions. Such a power would ensure that it was able to make an independent assessment of failure in the market and the extent to which any corrective action is likely to protect consumers from future detriment.

The FCA should have powers with regard to market investigation and review as it not clear that these will be retained by the OFT or its successor body following the changes in the competition and consumer landscape being considered by the Government¹².

Questions 17 and 18: Co-ordination between the PRA and FCA, and the veto

The twin peaks structure proposed, in recognising the fundamental difference between prudential regulation and conduct of business regulation and in giving regulators clear

¹² BIS consultation "A Competition Regime For Growth".

objectives, promises to overcome some of the problems in the current single regulator system. The challenge will be co-ordinating the views of the different agencies and resolving conflict.

The foundation for this structure should be clear public policy objectives and accountabilities. Our experience across different sectors is that the high-level objectives of Government are rarely fully articulated, even in statutes, with the result that decisions can too often be made on the basis of inter-organisational politics and individual regulators' preferences and cultures.

The need to coordinate and consult between the PRA and FCA must not lead to undue delay in taking action that would prevent more consumers experiencing financial harm with the negative impacts this can have on consumers' ability to provide for themselves and their families.

The measures outlined in the consultation paper are welcome, in particular the cross membership of Boards. However there remain concerns that the FCA will not be an equal partner as its decisions can be vetoed by the PRA.

While we accept that there may be exceptional circumstances where a veto on an FCA activity might be needed we believe that any use of the veto should be regarded as likely to have arisen from the failure of the PRA or FCA or both to achieve their objectives. Any use of the veto should lead to an inquiry of what went wrong. The presumption must be that the results of the inquiry must be made available not only immediately to the Treasury Select committee but also to the public within an appropriate timescale.

Given that there are mechanisms where the PRA and FCA can work together to consult and agree on a course of action any resort to a veto would be likely to occur in a scenario whereby the FCA believes that without action a group of consumers face ongoing detriment. The consultation document states that in some circumstances the PRA may need to use its veto to prevent a disorderly failure with possible systemic stability consequences. We consider that the definition of what would have systemic stability consequences must be extremely narrow to avoid undue pressure on the FCA and/or the PRA not to take much needed action against firms.

The ongoing need for such measures will depend in part on the outcome of the Independent Commission on Banking's report into how to protect our economy and banking system and promote competition after the calamities that occurred in the crisis of 2008. It is vitally important that a robust and diverse financial system is created thus lessening the need for future intervention.

Regulatory processes and co-ordination

21. What are your views on the Government's proposals for the approved person regime under the new regulatory architecture?

We understand why dual regulation will give rise to dual powers in relation to approved persons in certain firms, but it is a complicated arrangement.

In addition, the paper does not explain how the approved persons regime will be applied to the consumer credit businesses transferring from the OFT and how this will be resourced. As stated above, an increase in fees, in order to support the higher level of scrutiny from the FCA, could lead to costs being passed on to the consumer and may not be sustainable for smaller credit businesses. This could prevent new businesses entering the market, including community-based projects.

23. What are your views on the Government's proposals on the treatment of treatment mutual organisations?

We welcome the Government's recognition that regulatory costs for mutuals such as credit unions and friendly society must be monitored. We wish to see diversity in the banking system and believe that regulatory costs should be proportionate to their size and risk.

28. Views on proposals for powers in respect of fees and levies

There is a huge difference between the typical fees paid under the current FSA and OFT regimes, and the period over which they apply. A move to a FSMA-based regime has the potential to result in a significant increase in fees for many firms. We support the Government's approach, as set out in its consultation on changes to the Consumer Credit Regime, that, in setting fee levels for authorised credit providers, the FCA will ensure proportionality and consider the appropriate level for minimum fee requirements for different types of business.

Consumer Focus wishes to see a healthy, competitive marketplace in credit encouraged. Well run small businesses, and other small players such as credit unions, microfinance schemes and co-ops providing a wide choice of products, services should be actively encouraged to form part of the credit market. We would not want to see these types of organisations excluded from the market by the fee regime.

FOS and transparency

30. What are your views on the proposals relating to the FOS particularly in relation to transparency

Too many complaints are being referred to the FOS by consumers dissatisfied with the response they have received from their provider. The FOS says it settles over 150,000 complaints each year¹³. For the year 2009/10 the FOS upheld 50% of the disputes it investigated¹⁴. The high upheld rate by the FOS on consumer complaints is evidence that the high number of complaints is a result of firms not dealing properly with the complaints they receive by ensuring where they are at fault they put things right and provide adequate redress.

We welcome the clarification on the FOS's ability to publish information including its determinations. We believe this should include the publication of the names of firms that are involved in the detriment as this will allow consumers to have the confidence to seek redress (see box below.) The FCA should step in promptly in response to information gathered by the FOS of unfair behaviour by financial providers. Early intervention by the FCA will be needed to curtail detriment and prevent consumers needing to embark on a lengthy process to get redress for practices that the FOS as identified as unfair. This

¹³ <http://www.financial-ombudsman.org.uk/about/index.html>

¹⁴ <http://www.financial-ombudsman.org.uk/publications/ar10/dealt.html#ar3b>

should link it with the FCA approach to product intervention which we commented on earlier in this response.

In a recent case involving Clydesdale Banks¹⁵ the bank revealed it had failed to accurately calculate interest rates for some of its variable and tracker mortgage holders, meaning minimum repayments were set at too low a level. The bank apologised for the error but still sought to recoup the resulting shortfalls by increasing payments. Reports suggest that this might have added over a hundred pounds to some customers' monthly bills.

Clydesdale Bank continued to take these retrospective payments despite clear indications from the FOS that consumers shouldn't be held responsible for errors of this type. FOS publicly clarified its approach in September, leaving no room for confusion. Consumer Focus has written to the FSA calling for action because Clydesdale Bank should take into account the FOS's decisions and its approach on mortgage underfunding. Instead the bank has continued to levy higher payments and not compensate customers who complained, leaving them with little option but to pursue the issue with the FOS.

FOS data published this week showed that in the second half of last year complaints from Clydesdale Bank customers about mortgages increased by more than 600 per cent on figures from January to June 2010. Clydesdale Bank mortgage customers who have taken their case to the Ombudsman have had their complaint upheld in 87 per cent of cases, against an industry average of 36 per cent.

Customers report receiving thousands of pounds back from the bank after the Ombudsman ruled in their favour. However the FOS did not name the bank concerned meaning that only tenacious and/or well-informed consumers got full recompense.

¹⁵ <http://www.consumerfocus.org.uk/news/consumer-champion-calls-on-clydesdale-and-yorkshire-bank-to-do-the-right-thing-by-its-mortgage-customers>

Compensation, dispute resolution and financial education

31. What are your views on the proposed arrangements for strengthened accountability for the (Financial Services Compensation Scheme) FSCS, Financial Ombudsman Service (FOS) and Consumer Financial Education Body¹⁶ (CFEB)?

We agree that the publication of, and consultation about, their annual reports by FSCS and FOS should be put on a statutory footing, but we consider that accountability must also include engagement with consumers. We believe that each of these organisations (ie including CFEB/Money Advice Service) should also be required to produce an annual consumer engagement strategy.

The process of consultation carried out by CFEB, now Money Advice Service (MAS), in relation to its annual plan, was not designed to achieve engagement with consumers. For example, the draft plan was not on the CFEB website for comment. We consider that in its new formation as MAS, the organisation should pay greater regard to being accountable to consumers and seeking out their views.

The previous section proposes that the law will be clarified, so that the FOS will be able to publish information about its determinations. This should raise its profile with consumers, who will recognise it as an organisation able to hold the financial services industry to account. Concrete examples of dealing with poor performance on the part of financial services bodies will give it increased credibility among the public.

We are aware of the efforts the FOS has made to strengthen its relationship with on-the-ground advisers and to improve its recognition within local communities. We would like to see the MAS take similar steps to engage with consumers. The suggestions elsewhere in this response on consumer engagement may also prove relevant.

¹⁶ Renamed the Money Advice Service, as of 4 April 2011



Consumer Focus response to HMT consultation on a new approach to financial regulation: building a stronger system

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