



**Consumer
Focus**
Campaigning for a fair deal

A new approach to financial regulation: judgement, focus and stability

October 2010

Introduction

Consumer Focus is the statutory organisation campaigning for a fair deal for consumers in England, Wales, Scotland, and, for postal services, Northern Ireland. We are the voice of the consumer and work to secure a fair deal on their behalf.

Consumer Focus has been active in the debate on regulation, developing sector-specific expertise on regulatory structures, cultures and methods and applying these in our work across the economy.

Our submission will essentially be focused on the Consumer Protection and Markets Authority (CPMA) but our comments apply across the structure. For the market to work it must work for consumers and citizens. There should be no fundamental conflict between prudential regulation and conduct of business regulation because both seek to protect consumers. Public policy considerations need to also be taken into account because of the nature of the sector and its importance to society and the economy. Divorcing these elements from the prudential aspects of regulation is to shut off important sources of information and risk indicators and to deny the broader impact of financial services.

The ideal regulatory structure would:

- (a) put consumer interests first
- (b) be transparent, open and accountable
- (c) recognise its role in ensuring essential service provision and financial inclusion.

Other regulators start with an underlying obligation to people/consumers.

Ofcom's stated role is:

'We make sure that people in the UK get the best from their communications services and are protected from scams and sharp practices, while ensuring that competition can thrive. The Act (Communications Act) states that Ofcom's general duties should be to further the interests of citizens and of consumers. Meeting these two duties is at the heart of everything we do.'

Ofgem's role is

'Ofgem is the Office of the Gas and Electricity Markets. Protecting consumers is our first priority. We do this by promoting competition, wherever appropriate, and regulating the monopoly companies which run the gas and electricity networks.'

Assessment Criteria

In our response to this consultation we will be using a set of analytical criteria developed as part of a robust review of regulators conducted by Consumer Focus last year. *Rating Regulators*¹ analysed six key regulators, including the Financial Services Authority.

Our assessment framework consists of twenty indicators which together form the essential building blocks of a consumer-focused regulator. These are:

Legal framework

- statutory objectives and duties enable the regulator to adequately promote the interests of all consumers
- responsibilities between different actors are clearly defined, without gaps or overlaps
- structures are sensitive to devolved contexts
- the right tools for the job

Culture and accountability

- translates statutory objectives into consumer-focused priorities and values
- embeds a consumer focus across all levels of the organisation
- transparent about its activities
- accessible to the general public, including disabled users
- works effectively in a devolved setting

State of readiness

- identifies likely sources of consumer detriment, both now and in the future, which shapes work priorities
- uses effective mechanisms to understand the consumer perspective and translate this insight into sound decisions
- works effectively with others, including with consumer organisations
- influences the wider regulatory agenda

State of action

- empowers consumers to help achieve regulatory outcomes
- has effective incentives to encourage compliance with its rules
- chooses the appropriate regulatory approach in the circumstances, and intervenes in a timely fashion when needed
- gives priority to, and intervenes effectively on behalf of, consumers who are vulnerable
- uses enforcement tools when necessary to protect consumers

Impact and learning

- defines and measures its impact on consumers in terms of outcomes
- evaluates its work and embeds learning

¹ Consumer Focus, *Rating Regulators*, February 2009.

Regulatory principles

The current regulatory thinking, borne of an environment of budget cuts and efficiency, should not place a straightjacket on creative approaches and possible solutions in financial services. Regulators and policy makers should not be subject to the ebb and flow of regulatory rhetoric but rather need to assess the appropriate responses to each particular situation within the policy framework set. In the aftermath of a crisis quite different responses are required to those that may be called into play when the market is working well for consumers and the economy.

The proposed reform of financial services regulation has a dual role:

- (i) responding to the current crisis and seeking to prevent future crises
- (ii) focused on developing the best regulatory structure to promote a competitive consumer focused and socially useful market, one that is innovative and attractive to investors

The adjustment required in (i) may be specific and short term and therefore different to that required in (ii). We see future development of regulation as requiring two distinct stages with the first requiring some extraordinary measures and bold intervention until the market normalises or stabilises and has developed a maturity that sees market forces as a key regulatory factor. Without recognition that some significant change and intervention may be needed in the first instance it is unlikely that we will get to Stage 2.

The Food Standards Agency was set up in 1999 in the aftermath of the BSE crisis. It has a clear mandate to put the interests of consumers at the heart of regime in order to restore public confidence in food safety. Its origins have much in common with the current situation in financial services. It is now recognised as an exemplary regulator.

Cost and global competitiveness

It is particularly important that these regulatory changes are absorbed and not passed on to consumers. The burden of regulation is already borne significantly by consumers and the state through bail outs and cheap money, low returns on savings and limited lending facilities. There will be an opportunity for review when the market starts delivering for consumers and pricing better reflects costs and genuine competitive forces. The industry as a whole, and its individual players, can lead in this area and therefore it is within their power to deliver an environment where the regulatory burden can be reduced.

The global crisis has fostered a more uniform approach to regulation which will hopefully limit the extent and risks of regulatory arbitrage. As a financial centre it is unlikely that our competitiveness will be reduced and undermined as a result of good regulation. London has significant advantages as a financial centre such as language, time zone and well established infrastructure that will continue to support its strong position.

Interaction and responsibilities of the three financial regulatory bodies

The twin peaks structure proposed, in recognising the fundamental difference between prudential regulation and conduct of business regulation and giving regulators clear 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. This can create confusion, overlap and two significant gaps: a strategy gap and an accountability gap. These are dangerous enough when there is only one regulator, but their likelihood and impact are heightened in markets where there are two or more regulatory bodies, as will be the case in financial services.

We therefore propose that Government periodically issues a strategic statement, setting out what it expects the regulators to deliver and what the government's own role will be. Implementation is then a matter for the regulators, working within the strategic framework set by Government. This allows for clear accountability to the elected government, while making the most of the specialist skills and expertise within the regulator².

Responsibilities between the different components of the regulatory system must be clearly defined, without gaps or overlaps. There are a number of areas where there are overlaps; such as in relation to supervision of firms where the Prudential Regulation Authority (PRA) and CPMA, or the Bank of England and CPMA have an interest. It is unclear how these will be resolved and which organisation's objectives will apply. In other areas there is a separation of responsibility which could compound the current problems with consistency and co-ordination, such as the proposal for a split of licensing responsibility between PRA and CPMA, in addition to the existing separate system for credit licensing. And there is the blurring of the intended split between prudential and conduct responsibilities, with the CPMA continuing to be the prudential regulator in those areas not covered by the PRA.

It seems the intention is to move towards objectives-based regulation but the proposal still has remnants of activity-based regulation and a further distinction based on the type of business. This could lead to duplication of the burden on firms and inaction as a result of confusion over responsibility.

² Consumer Focus Fresh Thinking, *Regulating in the consumer interest*, March 2010

There are lessons we can learn from other jurisdictions. The Netherlands has a twin peaks regulatory structure. This model of regulation works well because it ensures that each regulator has a clear focused sense of purpose, and 'should never be in a position where it is tempted to sacrifice the goal of transparency to prudential concerns and vice versa'.³ The overlaps in the proposed system need to be clarified.

The proposed system implies a precedent with the Financial Policy Committee (FPC) and PRA having the upper hand and so is not a pure twin peaks model. The CPMA must have regard to the FPC and PRA objectives and is required to consult with the other bodies in relation to impacts on these but the obligation is more limited in the other direction. Our concerns about the separation echo a previous comment by Clive Briault, the former Director of Prudential Standards at the FSA, in that 'the outcome may reflect the balance of power between different regulators at a particular point in time, rather than a rational and coherent consideration of the problems.'⁴ The CPMA must have sufficient tools, independence and powers to properly carry out its consumer protection functions, and in this respect they should be at least equivalent to those of the PRA.

A report on the twin peaks model to the Canadian Expert Panel on Securities Regulation suggests the need for a permanent co-ordinating body that will promote co-ordination of regulatory policy, sharing of real-time information and co-operation on enforcement matters. The body should not be ad hoc and co-ordination between bodies should not be left to an agreement between them⁵ but rather co-ordination should be by an independent legal authority which would 'have automatic access to the other's reports, work together on new rule making and co-operate on enforcement and supervisory matters.'⁶ A formal mechanism for co-ordination and conflict resolution needs to be put in place at the outset of a new structure.

While we welcome the focused attention on consumer protection issues we are concerned that the CPMA perspective will be undervalued or lost in the event of a conflict.

The House of Commons Regulatory Reform Committee has recommended that the Better Regulation agenda post financial crisis needs 'a greater diversity of input, including more accountability to citizens and end users'.⁷ All three bodies need clear public interest and consumer representation, as well as the cross-representation between the regulators, to ensure their perspective is broader and they have access to the best information. All three should be required to consider the consumer interest and there needs to be a clear authoritative mechanism to resolve conflict.

The respective Boards should have a variety of knowledge and skills and in addition to cross-representation need to include those with consumer, public policy, regulatory, economic and industry expertise as well as those who are able to represent the interests of the nations. They need to be cognisant of each other's work and facilitate an open exchange of information. At executive level the agencies need to be led by high profile and influential figures. Hector Sants' appointment to the PRA should be mirrored by a similar status appointment to the CPMA.

³ Hans Hoogervorst, The Chairman of the Netherlands Authority for Financial Markets, *Dutch regulator says 'Twin Peaks' supervision best*, <http://reut.rs/c7hu23>

⁴ Clive Briault, *Revisiting the rationale for a single national financial services regulator*, FSA Occasional Paper, February 2002.

⁵ The Australian system utilises a memorandum of understanding.

⁶ Eric J. Pan, *Structural Reform of Financial Regulation in Canada*, A Research Study Prepared for the Expert Panel on Securities Regulation p.42.

⁷ House of Commons Regulatory Reform Committee, *Themes and Trends in Regulatory Reform*, Ninth report of Session 2008-2009, July 2009.

The Bank of England and Financial Policy Committee

- **If you support the idea of secondary factors, what types of factors should be applied to the FPC?**

Consumer interests need to be considered throughout the regulatory system and at the FPC level should be reflected in consideration of stability and sustainability issues and in relation to market and public confidence. Rebuilding this confidence should be an immediate priority.

Confidence in financial services involves a wide range of factors and conflicts including confidence between institutions, as well as the confidence of users (and issues such as runs on assets which can in turn lead to system instability).

- **How should these factors be formulated in legislation – for example, as a list of ‘have regards’ as is currently the case in the Financial Services and Markets Act 2000 (FSMA), or as a set of secondary statutory objectives which the FPC must balance?**

Public interest and trust and confidence should both be ‘have regards to’ matters. In general these issues will be dealt with through a clear Government public policy framework but the FPC will have a role in alerting the Government to implications of policy or lack of policy on financial stability and vice versa.

Prudential regulation authority

4. The Government welcomes respondents' views on:

- **whether the PRA should have regard to the primary objectives of the CPMA and FPC**

Statutory objectives need to be clear and unambiguous, recognising that the different agencies have different functions. One of the criticisms of the FSA has been that there are too many objectives with no weighting or prioritisation, and focus on one tended to lead to neglect of another. The overarching and consistent objective should be promoting and protecting the interests of consumers..

- **whether some or all of the principles for good regulation currently set out in section 2 of FSMA, particularly those relating to good regulatory practice, should be retained for the PRA**

The principles generally seem prudent and sensible but their execution needs to be on the basis of broad evidence and transparent decision making. 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 constitutes a restraint on exercising powers, and that consideration of the burdens or restrictions imposed is conducted in isolation of the benefits or in underestimation of benefits that may not be easily quantified or that don't have such influential and well resourced advocates.

- **whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained**

The FSA was reluctant to intervene in markets, giving emphasis to innovation which had its expression in exuberant risk taking rather than new products and services designed for the demand side of the market. Part of the reluctance may have been due to the criticism by industry that intervention was likely to inhibit competition. The danger of competition as an objective of the regulator is that the regulator moves into the role of promoting the industry. Competition of itself should not be an objective but one of the mechanisms to deliver outcomes for users. It's value in achieving this needs to be monitored and supplementary or alternative tools used where outcomes are not being achieved.

Taking into account the desirability of maintaining the competitive position of the United Kingdom was in direct conflict with a broader competition objective. The lack or failure of competition has been a key issue in the sector for a number of years with consolidation increasing and little diversity in products and models. These factors need to be reviewed.

It is important that the statutory provisions supporting the new regulatory structure provide for consideration of the impact of its regulatory activities on competition. This should be supported by a greater role for stakeholders, including consumers and consumer groups, to raise competition issues in relation to financial services. The promotion of diversity and products available to meet the needs of different

groups of consumers should be a strong public interest consideration in supporting consumer protection and confidence in the market.

While competition underpins functioning markets, it is a means to an end and so should not take priority over other objectives. We believe there are advantages in competition being dealt with by a specialist body to ensure consistent approaches are taken to competition and market issues across sectors and in order to better deal with cross market issues. It allows the regulator to get on with regulating.

- **whether there are any additional broader public interest considerations to which the PRA should have regard**

The societal implications of the failure of financial markets, and the significant taxpayer investment in the market, underline the need for consideration of defined public interest objectives in regulating the area and regular assessment of outcomes against these objectives. It is clear that there is need for a culture change and a need to address what Adair Turner has referred to as the 'social uselessness' of parts of the sector,⁸ indicating problems with the fundamental operation of the market. The sector does more than just provide us a range of products and services that are optional. It provides essential services, fundamental to the broader economy, and because of this the terms on which they are provided need to be monitored.

Few people now trust the banks to do what is right.⁹ Trust and confidence in the sector fell by 11 per cent between 2008 and 2009. For those big brands directly associated with the crisis the fall was much larger.¹⁰ Research by CII shows one in five UK consumers believe that they will never trust financial services again.¹¹ Without restoring confidence some of the important public policy goals that are central to reviving the sector will be lost. Promoting a savings and banked environment and sustainability in the social, economic and environmental sense is a key to recovery and a more stable system for the future and should be at the heart of what the PRA does.

Public policy considerations feature in the Canadian financial system, which is notably risk averse and also has been relatively unscathed by the recession. There is a great emphasis on savings and the savings culture is generally more sustainable and long term. Consumption is more heavily taxed than savings and income, and there are no particular tax incentives associated with home ownership. As a result Canadian institutions remain reasonably well capitalised and Canada did not experience a bubble and burst in house prices.¹² The regulator needs to have a strong public policy framework and clearly operate in the public interest.

In addition to the principles in section 2 we would suggest adding the following as matters to have regard to:

(a) the public interest, including:

⁸ Adair Turner, *What banks do, What should they do and what public policies are needed to ensure best results for the real economy?* Speech to Cass Business School, 17 March 2010.

⁹ The Edelman Trust Barometer shows that since 2007 this has plummeted 20 points from 41 per cent to 21 per cent in the UK, <http://bit.ly/aPReOH>

¹⁰ Milward Brown OptimorBrandz, Top 100 most valuable brands 2009

¹¹ CII/YouGov 2009

¹² Pietro S. Nivola and John C. Courtney, *Know Thy Neighbour: What Canada Can Tell Us About Financial Regulation*, The Brookings Institution, April 2009; <http://bit.ly/aJrdnw>

- the public perception of the market and in particular, the fairness of the market
- furthering the interests of citizens and consumers
- promoting a sustainable market and products and services (including consideration of long term impacts such as broader social, economic and environmental impacts)
- regulating essential service provision
- furthering the interests of vulnerable and disadvantaged consumers

5. Is the model proposed in paragraph 3.16 – with each authority responsible for all decisions within their remit subject to financial stability considerations – appropriate, or would an integrated model (for example, giving one authority responsibility for authorisation and removal of permissions) be preferable?

We already have two licensing systems in retail financial services which operate in different ways. Introducing a third, with a further set of objectives, is likely to increase the regulatory burden and lead to further inconsistency, lack of co-ordination and barriers to entry. It is important that authorisation/licensing standards are consistent across the board but there is the capacity to differentiate in standards and regulatory requirements in terms of risk. A joint licensing and review board, responsible for authorisation and removal, is a preferable option.

The licensing system itself has the potential to better shape the sector in a way that is more responsive to market and consumer issues. Reform of the licensing system would provide an opportunity to reconsider the objectives of licensing and its potential as a regulatory tool to drive a fairer market place. Key elements such as judging the integrity of a firm as part of the authorisation process, as suggested recently by the Chief Executive of the Financial Services Authority¹³, and looking at fairness and consumer and market factors as threshold conditions provide a basis for these to be monitored on an ongoing basis. Regular reviews with the power to remove licences or alter the licence conditions where threshold conditions are not being maintained or practices are called into question would better support the current supervisory system.

6. Is the approach outlined in paragraph 3.17 to 3.23 for transfer of regulatory functions and rule making sufficient to enable the PRA to take a more risk-based, judgement-focussed approach to supervision?

Powers and functions of the PRA

The Financial Services and Markets Act 2000 (FSMA) provides a useful starting point as a template, bearing in mind that this formed the underpinning of a regulatory system that was not appropriately equipped to deal with the financial crisis. In some instances the tools were there but there was hesitancy in using them¹⁴ (and in some instances concerns about the legal basis for such powers such as the publication of information on investigations and the previous s.404 power), in others the tools need to be enhanced.

The adoption of FSMA provisions should first consider how or if they have been utilised at all or effectively and remove any impediments to their operation. A strict separation of conduct and prudential powers will need to be considered carefully as there is necessary overlap and a need to co-operate and exchange information on these.

¹³ Mansion House Conference on Values and Trust, 4 October 2010.

¹⁴ Particularly in areas such as PPI, unfair charges and where there was evidence of practices that breached the treating customers fairly obligations.

There is an anomaly in the PRA authorising some institutions but not supervising them. It is likely that there will be differences in the application of the threshold conditions and requirements for ongoing satisfaction or review of these conditions if responsibility is split between 2 regulators.

Rule making

While wide consultation is necessary in carrying out the conduct of business rule making function, the consultation should not be such that it is in effect a substitute for action where there is evidence available on which to act. The consultation process itself can be subject to delays which of themselves can impact on the stability of the system.

Where intelligence gained through supervisory and enforcement activity and analysis of monitoring and complaints data reveals a real problem it requires an efficient response. We have seen the problems that arise through lack of action in the areas of mis-selling of PPI insurance and unfair charges, areas that could also have been addressed through using the wider implication process. Unfair or risky practices have the potential to impact on the stability of the system through fostering models that are unsustainable. The regulator must have, and must be prepared to exercise, an effective wider implications power. We are hopeful that the recently amended s404 will be utilised by the new regulator.

Where consultation on rule making occurs it must be open and transparent, showing clearly who has been consulted and the evidence provided. Evidence needs to be analysed and balanced and reasons given for any decisions made as a result of the consultation. We have been critical of the FSA being subject to industry capture. Consumers need to be engaged and informing these processes and consultation with the Consumer Panel, in addition to other consumer bodies, should go hand in hand with consultation with the Practitioners Panel.

9. The Government welcomes views on the measures proposed in paragraphs 3.28 to 3.41, which are designed to ensure that the operation of the PRA is transparent, operationally independent and accountable.

Our general views on transparency and accountability across the regulatory structure are contained in our response to question 11.

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 and the perception of the Bank acting as an 'advocate of City interests within the Government'¹⁵ remains. We will need to see, in the words of the IMF, robust mechanisms to ensure transparency and a high degree of accountability of the Central Bank's actions in practice. There should be the same level of accountability across the regulatory structure.

¹⁵ 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.

Consumer protection and markets authority

10. The Government welcomes respondents' views on:

- **whether the CPMA should have regard to the stability of firms and the financial system as a whole, by reference to the primary objectives of the PRA and FPC**

We propose the CPMA objective should be re-framed so that it has the primary objective of protecting consumers and promoting consumer interests while having regards to confidence in financial services.

The regulator should have clear statutory objectives primarily focused on the consumer interest.¹⁶ The FSA currently has five objectives that are not weighted, where the discretion as to which has priority is left to the regulator. Objectives should be clear and unambiguous and where there is more than one they should be prioritised so there is sufficient guidance to and accountability of the regulator.

The organisational structure appears to subjugate consumer interests to other interests. Financial stability is fundamental to consumers in terms of the provision of low risk sustainable products and services that are both essential to their engagement with society and the economy and fundamental to the long term recovery and restoration of confidence. In many cases these interests will coincide but when they don't it appears the matter becomes a public policy issue and should be referred to the Government of the day. For example where a firm's survival or the survival of the prevailing business model of firms may be impacted by consumer protection measures or risk measures, should it really be consumers or citizens that suffer?

- **whether some or all of the principles for good regulation currently set out in section 2 of FSMA should be retained for the CPMA, and if so, which**

The principles seem prudent and sensible but their execution needs to be on the basis of broad evidence and transparent decisions. 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 constitutes a restraint on exercising powers. 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 that don't have such influential and well resourced advocates.

¹⁶ Consumer Focus, *Regulating in the Consumer Interest*, March 2010.

- **whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained**

Innovation should be consumer focused and have consumer benefits – impacts on innovation should only be considered after weighing the benefits to the consumer of innovation against any detriments (such as reductions in protection or particular impacts on segments of the market, particularly vulnerable and low income consumers). Innovation in the sector has increasingly been about gaming the market and not delivering for the consumer.

What is needed is innovation that promotes choice and offers real value for consumers, innovation that fosters good personal financial management so that consumers are able make appropriate choices throughout their adult lives.

The FSA was reluctant to intervene in markets, giving emphasis to innovation which had its expression in exuberant risk taking rather than new products and services designed for the demand side of the market. Taking into account the desirability of maintaining the competitive position of the United Kingdom was in direct conflict with a broader competition objective. The lack or failure of competition has been a key issue in the sector for a number of years with consolidation increasing and little diversity in products and models. These factors need to be reviewed.

It is important that the statutory provisions supporting the new regulatory structure provide for consideration of the impact of its regulatory activities on competition. This should be supported by a greater role for stakeholders, including consumers and consumer groups, to raise competition issues in relation to financial services. However, we believe there are advantages in competition being dealt with by a specialist body to ensure consistent approaches are taken to competition and market issues across sectors and in order to better deal with cross market issues. It allows the regulator to get on with regulating.

The Canadian system provides a good example of where good regulation promotes a market that works for consumers even in the absence of competition. Canada's banking sector is very concentrated, led by five major banks involved in combined activities, but the customer experience in relation to most measures of consumer welfare – service fees, credit card costs, interest spreads on intermediated credit, etc – compares favourably with those in other advanced countries.¹⁷

- **whether there are any additional broader public interest considerations to which the CPMA should have regard.**

We suggest adding the following as matters to have regard to:

(b) the public interest, including:

- the public perception of the market and in particular, the fairness of the market
- furthering the interests of citizens and consumers

¹⁷ Pietro S. Nivola and John C. Courtney, *Know Thy Neighbour: What Canada Can Tell Us About Financial Regulation*, The Brookings Institution, April 2009; <http://bit.ly/aJrdnw>

- promoting financial inclusion, and in particular the interests of vulnerable and disadvantaged customers, by encouraging access to suitable and affordable products and services
- promoting an economically, environmentally and socially sustainable market and products and services
- regulating essential service provision
- promoting public understanding of the financial system (meaning accessibility, understanding of products and pricing, complaints and redress mechanisms, openness and transparency of regulators and service providers)
- promoting diversity in the financial services sector

11. Are the accountability mechanisms proposed for the CPMA appropriate and sufficient for its role as an independent conduct regulator?

An effective regulator needs to:

- detect systemic risk issues before they become entrenched
- enable early intervention in relation to unfair practices such as the mis-selling and unfair terms and conditions associated with PPI
- investigate models that are unfair, hamper choice and obstruct good personal financial management, such as the hidden charges model in the provision of current accounts
- consider areas where uncertainty and lack of control over payments negates financial capability

Setting standards, supervision and enforcement

The new regulation should see the development of an effective radar to identify hazards, risks and practices before they become entrenched.

The stated new approach to Retail Conduct of Business holds out the promise of intervention on price and products, recognising and responding to ‘some of the unique characteristics of retail financial services that call for a more intrusive approach’.¹⁸ These changes will require greater interrogation of firm’s business models and strategies to minimise the risk to both consumers and the system. While this model is not new to prudential regulation, which monitors closely and pre-empts hazard, the new conduct approach 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 lest the new regulator appears as the same body with a new set of clothes.

We welcome the commitment to a strong and credible enforcement function, part of this will be clarity of objectives and the powers and tools to carry these out, part will be the practice, and part will be the public policy framework that supports the regulator and is resistant to lobbying and short term gains. We have been critical of the FSA in its failure to use its existing tools such as the capacity to intervene through the authorisation standards and reviews where practices or models are not sustainable, and to utilise the wider implications and the information and investigation powers. And there are some useful new tools in the amendments to the FSMA that came into force in June this year that should not be left to rust, such as the power to impose suspension or restrictions on authorised persons (which could be suspending a firm from selling a particular product), and removing the previous restrictions on imposing a financial penalty and withdrawing a person’s authorisation.

¹⁸ HM Treasury, *A new approach to financial regulation: judgement, focus and stability*, July 2010

The US Consumer Financial Protection Bureau has been given specific powers in this area and will be able to autonomously write new rules to oversee and govern faulty financial products. We need to be sure that current and proposed powers give this level of clarity.

Transparency and empowering consumers

Transparency in the exercise of its functions is vital. The FSA has been a reluctant reputational regulator. It does not reveal details of investigations until concluded, nor does it provide information about the firms that are not satisfactorily complying with requirements.¹⁹ Positive steps have been made recently with the requirement on banks to publish complaints data but more and better information is needed so that consumers can make real choices and businesses are more motivated to treat their customers fairly.

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.

The FSA has indicated that the FSMA and other laws prevent them from both disclosing early information about enforcement action and the compliance records of firms. The Information Commissioner's decisions in relation to freedom of information applications reveal that different legal interpretations exist.²⁰ It shows the influence of the industry and the timidity of the regulator that FSA have not even tried to exercise its powers in this respect. It is also a signal that the future regulatory regime should not only ensure justice is done but must be seen to be done and that any suggestion of legal impediments needs to be removed through clear drafting of powers.

The industry is concerned about reputation, however there is no reason the financial services industry should not be subject to the same rules that any firm facing civil action is subject to. The OFT Supreme Court action on unauthorised overdraft charges identified firms at initiation of action. Although the action was unsuccessful it provided valuable information to consumers about how different firms were dealing with them and consumers themselves became part of a public campaign to address unfairness in the system. It had an impact on firm's behaviour, at least in the short term while there was threat of an adverse decision, and brought charges down, as well as resulting in agreement about greater transparency of charges.

Civil cases and enforcement actions take years to complete and even then often go on to appeal. In a market where consumers are unlikely to initiate individual civil actions against their banks it is up to the regulator to make positive interventions in the market and for these to be transparent in order to empower consumers to make their own assessments.

The Australian regulator, ASIC, will be empowered under the Corporations Amendment Regulations 2010 to publish infringement notices. Under the regulations firms are issued with an infringement notice where ASIC believes that they have contravened the Act and are given the opportunity to remedy the contravention through complying with the infringement notice within 27 days. At the end of the compliance period, whether there has been compliance or not, ASIC may publish the infringement notice. *Section 7.2A.16*

¹⁹ Ibid

²⁰ Ibid

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 the regulator's activity and to developing an understanding of the role of the regulator. Consistent standards on publishing information need to be adopted across the regulatory environment and the greater co-ordination between roles the development of processing one data base of information.

In light of the CPMA's main objective of promoting consumer interests, the separation of prudential regulation, and the greater power and propensity to intervene early to prevent unsustainable practices and products from gaining a foothold there seems no reason that the CPMA should not become an exemplary reputational regulator.

The Conservative White paper for sound banking expressed support for this principle in stating: 'We will ensure that the CPA names and shames firms which break the rules. This will act as an incentive for firms to improve their behaviour.'²¹

Naming and shaming or naming and faming is used successfully by other UK regulators to provide information to empower consumers. Both Ofcom and Ofgem name firms at the time of launching investigations. Ofgem also rates performance through its annual quality of service reporting and the Food Standards Agency publishes performance measures via its traffic lights system and their Scores on the Doors initiatives.

Impact and learning

The ambition of regulation must be to change the culture and norms of industry so that businesses start to act in the spirit of the governing rules rather than seeking to merely meet the letter of those rules and test the boundaries of what they can get away with. The principles based approach within the FSA has been accompanied by an outcomes performance report, a commendable approach which did however need more work in terms of how outcomes were measured. It is important that high level principles such as Treating Customers Fairly actually deliver outcomes, rather than imposing a regulatory burden on firms which has no impact on culture and actions. It appears that more guidance in this area is necessary and some clear incentives or disincentives applied to encourage behavioural change.

Ofcom uses its consumer experience reports to evaluate the impact of their regulatory policies and activities on consumers, providing them with a means of translating consumer insight into decision making. Ofgem has a reporting framework for its social and sustainable initiatives that measure performance against a range of indicators.

Enhancing the own initiative variation of permission (OIVOP) powers to enable supervision to feed into regular review and to maintain standards will be significant in the CPMA's ability to provide effective consumer protection and to promote a sustainable market that better serves the public interest.

²¹ Conservatives Policy White Paper, *From Crisis to Confidence: Plan for Sound Banking*, July 2009.

Remedies and redress

The CPMA should be more focused on the impacts of the system and behaviours and practices on consumers. Restitution orders need to be better utilised and more information should be available to consumers about how to seek these.

Mechanisms for collective action and redress and powers to act in situations that are likely to result in mass harm and have wider implications are fundamental to both efficiency and trust and confidence in the new system. There is a great consistency about the complaints in the financial services area, centring around particular products and practices. PPI and current account charges top the polls year after year. If the regulator is not going to act, then consumers need efficient procedures to initiate action and seek redress where the loss to individual consumers is small and therefore uneconomic to pursue. It is an important deterrent to poor business practices.²²

We do not want to see the regular emergence of a mis-selling scandal or unsafe practice involving high consumer detriment and huge numbers of complaints to the FOS. As Adair Turner comments, 'this periodic process of large scale customer detriment and then customer compensation is not an acceptable or sensible model for the future.'²³

Accountability and accessibility

The regulator needs clear accountability processes to foster its legitimacy, providing information about working methods, decisions, reasons for decision and how performance is measured so that organisations, the public and the media can scrutinise its work and to ensure it is free from bias towards influential interests.

A regulator needs to consult widely and decide openly on the basis of its consultation and information gathering. FSA produces documents often in technical language and does not publish responses to public consultations, a step we called for in *Rating Regulators* over a year ago²⁴, and so it is sometimes difficult to see the weight of evidence behind decisions and there is the perception that decision making is very much behind closed doors. A regulator needs to be both pro-active in collecting information and responsive in receiving it. Consideration of the internal advice from panels, the external information from stakeholders as well as the commissioning of independent information gathering is fundamental. How this information is then used to make a decision is also important.

Board and management structures need to retain and enhance the current consumer representation, and the executive committee with responsibility for taking significant supervisory and regulatory decisions needs to have membership with an understanding and experience of consumer issues as well. In addition to an internal consumer perspective there needs to be an obligation to consult widely with stakeholders and those affected by the regulator's decisions. The Board should hold public board meetings and publish its papers in advance in line with regulatory best practice.

The Food Standards Agency invites the public to attend open Board sessions which are held at venues across the UK. A question and answer session is held at the end of Board meetings, at which members of the public can raise issues of concern. Board meetings are also webcast and there is a freephone listen-in service to ensure that cost is not a barrier to anyone who wants to engage in the decision-making process. Minutes of meetings between senior staff and key stakeholder groups are also made available on the Agency's website.

²² In the absence of Government action in Australia consumers have joined forces in a class action in relation to unfair bank charges, significant cuts in fees have been made recently by the banks concerned in response to the public outcry. <http://bit.ly/bs7LGn>

²³ FSA Annual Report, 2009/10

²⁴ Consumer Focus, *Rating Regulators*, Financial Services Authority, February 2009.

We welcome the accountability mechanisms proposed in terms of corporate operations, and in particular reviews by the National Audit Office. These mechanisms should apply throughout the regulatory structure.

In order to be accountable to the public the regulator needs to be accessible to the public and provide information in a timely and comprehensible way for a range of audiences, not just for the industry. It needs to do more than sit at Canary Wharf in the middle of its industry. It needs to engage and provide real opportunities for consumers to contribute to the work on the CPMA. Its engagement strategy should provide:

- Opportunities to engage in the CPMA'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

With much of the communication and consumer expertise moving across to CFEB the new regulator has to reinvent itself and look at how it communicates and interacts with the broader community. The advantage of a CPMA will be a consumer focus but it needs to be able to relate to consumers, to promote itself and to understand their perspectives. It needs a diversity of staff from different backgrounds who can take a wider and more relevant approach. This includes those with financial services expertise as well as public policy and regulatory experts²⁵ and consumer experts.

To complement and inform the regulatory role informal and accessible mechanisms for dealing with complaints need to be available. The role of the FOS in safeguarding the consumers interests is of vital importance and it must be adequately resourced to do its dual job of protecting the interests of individual consumers and gathering information on potential areas of detriment that need urgent attention by the regulator.

Given the split in regulatory functions (particularly between credit and deposit taking) and the rather confusing plethora of regulatory rules there is a strong case for a single point of contact for consumers to provide consumer friendly information and refer to the appropriate body. There should also be an obligation to produce uniform complaints information to provide consumers clear guidance about where and how they can complain.

Credit

Although we are aware that regulation of credit activities will be the subject of a separate consultation it seems a missed opportunity that it is left out of this exploration of regulatory reform. The impact assessment has assumed that the CPMA will be responsible for consumer credit regulation. Both Coalition parties expressed a commitment to resolving the anomalous situation of retail banking regulation being split between two regulators. A new consumer regulator should absorb regulation of credit functions but be mindful that consumer regulation requires a different approach. In many ways the OFT was much more focussed and accessible in its regulation, mindful of consumer and market factors as important considerations in the licensing process, and more likely to take enforcement action when things went wrong. We would want the advantages of the credit licensing system in this respect to transfer to the CPMA.

²⁵ See Mervyn King's evidence to the Treasury Committee on 6 August 2010.

Devolved working

Even though financial services are a reserved matter, it is important to embrace a genuinely UK-wide culture and for the regulator to respond to possible differences in the needs of consumers in the nations. They should also be mindful of impact on consumers of the differences in the legal system in Scotland. If regulators are not sufficiently tapped in to the policy environments of the nations they risk taking decisions that have unintended negative consequences in these arenas. Successful devolved working would include a physical presence in each nation, board members drawn from the nations, engagement with national decision makers and stakeholders, research on and targeting of particular issues, and reporting specifically on activities in the nations.²⁶

12. The Government welcomes views on the role and membership of the three proposed statutory panels for the CPMA

We agree that the panels are an important consultative mechanism and we support retention of the Consumer Panel within the CPMA but with a wider remit to hold discussions on pertinent issues with the PRA and FPC. We have had little interaction with, and limited knowledge of the work of the Practitioner's panel and the Small Business Practitioner Panel but are optimistic that in a Consumer Protection Authority that will change. In a consumer focused regulator these bodies need to more than a mouthpiece for industry but must be transparent in promoting best practice in customer service and customer focused innovation. While the Consumer Panel provides evidence based proposals through a body of independent research, the other panels seem to provide a more subjective view through the opinions of their constituents. It is hard at times to distinguish these roles from that of industry bodies as a result.

There needs to be an opportunity for the panels to test their views against each other with the possibility of coming up with workable solutions that recognise the others interests, rather than the shuttle diplomacy approach that is common. And the accessibility and transparency provisions need to apply equally to the Panel's work and to the FSA's considerations of their input.

The Consumer Panel is seen as one of FSA's current strengths but it is also important that the regulator liaise with external stakeholders to get a broader view and a better understanding of the views of consumers. Regulation needs to be designed around the needs of those it is meant to benefit and this requires a direct dialogue with consumers and their representatives.²⁷ As consumers may not seek out the regulator and consumer groups may not have the resources to engage in the same way as business interests, the regulator should be pro-active in consumer engagement, seeking out consumers where they live and on their terms to ensure genuine engagement. External perspectives need to be sought in relation to the individual experiences of consumers as well as alternative policy perspectives and models developed from experience and understanding of different markets and different interests. There is a concern that these broader views may be lost in the efficiency drive that is the Government's consumer landscape review and that the already strong and influential voices of industry will not be sufficiently countered.

We have been critical of the FSA not having a formal programme of consumer research outside its financial capability area. This gap will become particularly apparent with the capability work moving to the CFEB. In *Rating Regulators* we commented that:

²⁶ Consumer Focus, *Rating Regulators: Financial Services Authority*, February 2009.

²⁷ Consumer Focus, *Rating Regulators: Financial Services Authority*, February 2009.

'The absence of an annual research programme, in the mould of Ofcom's Consumer Experience Report, appears to limit the FSA's ability to maintain an overview of consumer attitudes and experience across its remit and over time.'²⁸

We would encourage the regulator to develop a research programme that included deliberative as well as qualitative research and for important sources of consumer information such as complaints data to be properly analysed rather than just remaining a numbers exercise.

Ofgem launched a programme called *Consumer First* in 2007 which is designed to lead to 'a qualitative improvement to decision making' using qualitative and quantitative research and exploring the needs of different sectors of the market, and in particular those of vulnerable consumers. They have a Consumer Challenge Group, a panel of consumer representatives with expertise on energy issues and have also recently recruited a Consumer panel comprising 100 ordinary domestic consumers to act as a sounding board for Policy development. Ofcom use a similar mechanism in their citizen jury to provide feedback and input into decision making.

14. The Government welcomes views on the proposed alternative options for operating models for the FSCS

We support the FSCS remaining a single scheme under the remit of the CPMA who should have the capacity to consider the appropriateness of cross-subsidies (particularly if there is a move to ring fencing risk through narrow banking) and different levels of compensation and levy dependent on risk.

The current guarantee under the Financial Services Compensation Scheme and the guarantees that will be in place through implementing the EC Deposit Guarantee Scheme should be applied to each brand rather than each license, and to each depositor. Consumers identify with brands and clear information about the application of the scheme needs to be provided in branches on web sites and on all promotional material.

²⁸ As above, 22

Crisis management

20. What further powers of heightened supervision should be made available to the PRA and the CPMA, and in particular would there be advantages to mandatory intervention, as described in paragraph 6.17?

We support enhancing OIVOP and suggest a regular review process where supervisory perspectives, other bodies and consumers can provide input or register objections. The reviews would help to provide early warnings of risk as well as enhancing consumer protection by making a firm answerable for their ongoing conduct and practices, by placing conditions on licence or subjecting a firm to more intensive monitoring.

In other jurisdictions, such as Australia, the licensing system is used to ensure and enforce standards and individual jurisdictions have been prepared to withdraw licences for unfair treatment of customers.

HFC Financial Services, Credit Licensing Authority, Victoria, Australia, 12 September 1989, unreported.

The Consumer Credit Legal Service (on behalf of 57 clients) objected to the renewal of licence for HFC Financial Services. HFC were denied a licence on the basis that they could not be trusted to operate honestly, fairly or efficiently. Grossly improper practices included:

- Methods of collecting repayments
- Requirements of compulsory insurance (particularly PPI)
- Failure to refund insurance rebates after loans had expired
- Failure to inform prospective borrowers of the extent of their repayments
- Conscious failure to train staff

Paul Latimer, Australian Business Law, 28th Edition, CCH, 2009.



A new approach to financial regulation: judgement, focus and stability

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