

Consumer Panel calls for a clear vision on consumer protection

**Speech by Adam Phillips,
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to the BBA Seminar on the Financial Conduct Authority
The Consumer Perspective on the FCA**

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It is always a challenge when you are the third speaker on a subject to give a fresh perspective. We've already heard today from both Government and the FSA on how they see the new structure operating. I will give you the Consumer Panel's point of view and try to build on what has already been said.

I have been asked to cover three issues in particular:

- What do consumers want from the new regulator?
- The importance of the fair treatment of customers and the role of consumer protection
- How will conduct of business issues be affected?

Since this is a discussion of the role of the proposed new Financial Conduct Authority, I am not going to spend much time on issues relating to prudential regulation and stability of the financial system, nor will I talk about the wholesale markets. But, obviously, a secure financial system and efficient and clean wholesale markets are very important to consumers.

I should start by saying that I am enthusiastic about the creation of the new regulator. There are serious short term problems being created by the transition and there are quite a lot of details still to be sorted out to make sure that the roles of the FCA and PRA are complementary and sufficiently joined up. It is also essential that the FPC takes into account the wider impact on society of its action to protect the stability of the system. But at the general level the proposed change is a considerable move in the right direction from the point of view of delivering better service to consumers.

So what do consumers want from the new regulator, remembering that all of us here and our families are consumers? Consumers require:

- the widespread availability of products and services that meet key needs (for example planning for retirement), and which deliver on the expectations they create
- 'good' product innovation, rather than innovation that conceals cost or risk in the pursuit of providing an apparently better price or higher rate of return
- products which are presented in a way which is simple and honest and priced in a way that can be easily compared with other products of the same type
- a retail distribution structure that provides real choice for the customer, that operates through different channels and where competition works effectively to deliver value for money.
- A healthy mortgage market which lends responsibly to customers
- access to independent advice, free from product, provider and sales bias delivered in a way which meets the needs of customers with limited amounts of money to save, as well as the needs of the wealthy.

- a credit market which is accessible and which treats customers fairly
- a market that recognises and responds effectively to the needs of more vulnerable consumers, whether due to age, location or ability.
- And finally, adequate supervision and enforcement of conduct

So that is what consumers should expect from the new regulator at the most basic level and indeed the FSA has recently been doing a reasonable job of trying to address these issues more effectively than its predecessors. So what are the problems facing the new regulator and what should the FCA be doing differently from the FSA?

At the risk of reminding you what you already know, there is no such person as an average consumer and consumers in the financial services market are more heterogeneous than most. The most obvious difference is the distribution of wealth which is extremely skewed, with the top 1% of the population having 20% of national wealth and six times average income. Clearly people with a lot of money are able to spend more on financial products and services in a way that is not possible in many other sectors. This disparity in wealth and disposable income means that the financial services regulator has much greater problems than most other regulators – not only are the needs of individuals different, but the products and services they buy to meet these needs and the amount they spend is very different and is not closely related to their ability to understand how to use financial products and services.

Superimposed on this huge diversity of consumer needs and experience is the range of services the industry provides to its customers. If we ignore for the moment the wholesale markets, investment banking and the provision of capital to business and concentrate solely on retail consumers, there is still a huge range of services and products which this industry provides; transactional services and deposit taking, consumer credit and simple insurance products, mortgages and longer term secured lending, more complex insurance products and long term savings vehicles and pensions. The range of products and services is large and different industry sectors need very different regulation.

Finally there is the trend to transfer risk from the industry and government to the consumer. The most obvious case is pensions, but there are issues in the sale of credit, insurance and savings which are important drivers in the debate about consumer responsibility.

The FSA was constructed by merging seven independent regulators. This appears to have led to a rather siloed approach to thinking about regulation and, until recently, a focus on the process of delivering regulation with very limited strategic vision of the outcome that could be achieved by effective regulation of business conduct in the retail sector and of the best way to get there. The most obvious exception to this is the Retail Distribution Review which has involved a very strategic approach to regulation. The RDR aims to support the industry's response to long term trends like the increasing cost of providing good quality independent advice and the growing need for most people for such advice, given the move from defined benefit pension schemes to defined contribution. The very well signalled changes that are being introduced by the RDR aim to reduce mis-selling, improve value for money for the consumer and to introduce effective competition which limits the ability of intermediaries to extract excess profit from both the product provider and their customers.

One can argue about the extent to which the RDR will achieve all these objectives, but the important issue is that, unlike the Treating Customers Fairly initiative, the strategy is clear to everyone and the aim is to encourage a more efficient and competitive market, rather than relying on a somewhat fuzzy principle which may work very well at the level of a specific transaction, but which is not an effective way to regulate the performance of a whole sector. The problems with getting redress for customers who were mis-sold PPI being the latest and largest example.

The Panel wants the new regulator to have a clearer vision of its role in providing consumer protection, to be more strategic in its approach to regulation and to use effective competition as a tool to encourage good behaviour rather than relying entirely on the threat of sanctions after problems emerge. In its response to the original Treasury Consultation last year, the Consumer Panel proposed that competition should be a secondary objective for the new FCA because we believe that competition powers would enable the FCA to use competition to drive better industry behaviour. The key word here is **effective** competition. Effective competition is competition which delivers value to the customer by providing products and services which meet their needs at an acceptable cost. In a number of sectors in the retail financial services industry there is competition, but it does not pass the effectiveness test.

This is a good point to examine the recent debate about the extent to which the new regulator should be a “consumer champion”. It is not very difficult to find areas where the FSA has failed to protect consumers from detriment; PPI is the most recent example but don’t forget self-certification mortgages and split capital funds. Until recently the FSA has not been a proactive regulator in the area of conduct. This has resulted in a continued imbalance of power in the relationship between consumers and the providers of financial services and led to the original proposal from the Government for the new regulator to act as a “consumer champion”. This was a controversial proposal, to put it mildly. The Treasury Select Committee and the financial services industry have both been vocal in claiming that such a role would be an inherent conflict of interest for a regulator working in financial services. According to the Treasury Committee branding the FCA a “consumer champion” would be “inappropriate, confusing and potentially dangerous.”

I have to say that I find this reaction rather extreme, if not very surprising. I think most of us, speaking as customers, would agree that OFGEM, OFCOM and other similar regulators have done a good job for customers of their industries. All of them have been more effective at delivering consumer protection and value for money than the FSA. I think that the real danger here is in getting hung-up on terminology. What both consumers and the industry want is a regulator that will be effective and proactive in the pursuit of its duties so that it prevents the adoption of bad behaviour or the sale of bad products and ensures consumers are protected from the worst excesses of market forces. No one wants to see a regulator which is overly bureaucratic; after all, the costs of regulation are ultimately borne by consumers.

So to answer the questions what does the FCA need to do differently; much of the regulatory technology needed to provide this has been developed by the FSA and will be inherited by the FCA. It needs to be deployed in a way which is effective, efficient and timely, something which the FSA has struggled to do until very recently.

This provides an introduction to my second topic which is the importance of the fair treatment of customers and the role of consumer protection. I think we all accept that confidence in financial services has two elements; the first is the issue of stability; confidence that the firm providing the product or service will still be there when you need it. The second is that the product or service will work for you personally in the way you expect. I am not going to spend time on the issue of moral hazard and the special resolution regime other than to say that the compensation scheme is still not constructed in a consumer friendly way and that although the immediate impact of a repeat of Northern Rock might be easier to explain to those queuing outside, the collapse of a bank with several subsidiary brands or a large firm in other sectors could still be extremely damaging to large numbers of individual consumers.

The second element of confidence is built around consumers' expectation that they should be treated fairly. The Panel carried out research into consumers' perceptions of fairness in financial services last year¹. The conclusions were firstly that:

"Comparing fairness across a range of sectors retail is seen as the most fair (e.g. no quibble returns, competitive pricing, good face to face service).....financial services are regarded as less fair, being insufficiently competitive or accessible. The financial sector's damaged reputation, following the recent banking crisis and also previously publicised poor practice, acts as a further negative influence on perceptions of fairness in the sector."

And secondly:

"Treating customers fairly is seen to be particularly important in financial services as finances are seen to be an essential part of life. Most products were seen to have the potential to be less than fair to consumers.....products including disproportionate fees or charges were also seen as particularly unfair."

As I have already mentioned, the experience of fairness happens at the level of individual transactions, the objective of the industry and the new regulator should be to ensure that in the overwhelming number of transactions the customer feels they have been treated fairly. This is not the same as the customer always getting what they want. To quote the research again:

"One recurrent characteristic of participants' general experiences of unfairness were situations in which customers had felt let down because their expectations had not been met. Many of the unprompted anecdotes participants discussed at the beginning of discussions were situations in which a product or service had been sub-standard after a product had been purchased."

In other words, most customers expect fair treatment and they judge this by whether the product or service performs in the way that was expected. Unfortunately the language used by consumers to describe financial products is conversational, whereas the language used by the industry in the agreements consumers are expected to sign is opaque, complex and legalistic. The research the Panel has done suggests that the great majority of people expect to take responsibility for their own actions, but that they also expect to be treated fairly, which means to them that their expectations are met.

One of the reasons that the Panel has pressed very hard for the FCA to have more powers to regulate products and to release information to consumers about defective financial promotions, enforcement actions and complaints data is so that consumers have the necessary information to take informed decisions. This is a complex area, where transparency alone will not be sufficient, but the FSA has made a promising start by setting up the Conduct Risk division, launching a debate on product intervention and publishing the Retail Conduct Risk

Outlook report yesterday which explains, for the first time in a single public document, the consumer protection issues which are causing them most concern.

My third topic is how business conduct issues will be affected by the new structure. In this respect the Treasury's consultation document is reassuring in that it suggests that the FCA will be doing many of the things we have identified in the past which have limited the FSA, including swifter and more effective action on financial promotions, publicising enforcement actions at the warning stage, engaging with product design issues and taking a more proactive approach to ensuring effective competition in consumer markets. However section 349 of FSMA will still stop the FCA publishing data collected in the course of supervision without the permission of the companies involved. This perpetuates the situation the FSA has had to face where information, which would be useful to consumers and which would encourage firms to invest in providing a better service, cannot be published. As you are probably aware it has only been possible for the FSA to publish data on consumer complaints because of an industry agreement and that was facilitated by the Ombudsman publishing adjudication results by named company. Unlike the FSA the FOS is able to do this without seeking permission.

There are probably some of you that feel that publishing this kind of information is damaging to the reputation of the industry as a whole and can lead to the figures being massaged. That is not a reason for not doing it, it is a reason for effective supervision of conduct around the handling of complaints for example, something the FSA is now doing. League tables are always difficult to handle, but just as the Practitioner Panel's bi-annual survey shows what the industry thinks of the regulator's performance – not particularly good at the moment – so the publication of firm specific performance provides another perspective on the efficiency of the regulator. We can argue about the exact type of information to publish and its context, but the important thing is that relevant information drives better behaviour. It also reassures people that the regulator is doing its job, something which will be essential if we are to rebuild consumer confidence and engagement with the financial sector.

As I said at the beginning, I am pleased that the FCA looks like being given powers and objectives which will help it to be more effective than the FSA at eliminating most of the significant detriment consumers have experienced in the last 10 years. However, to be successful the style of regulation has to change and this is likely to have an impact on the way firms experience conduct supervision.

I would like to see the compliance departments of all retail firms thinking more about how their organisation can deliver fair treatment to their customers, in the way that other retailers and manufacturers of most consumer goods do nowadays. Car manufacturers try to construct their cars as cheaply as possible. The construction regulations ensure that key components regarded as essential for safety, like brakes and safety belts are installed and engineered to meet minimum industry agreed standards. This approach ensures that in spite of the pressure to keep costs as low as possible, the companies' quality control departments self-certify that the components meet the minimum standards specified in the regulations. I see no reason why the FCA could not start operating in this way to the benefit of both the customer and the industry.

The development of straightforward products which meet customer expectations, or simple products which set minimum standards do not have to restrict innovation or lead to generic markets. What these initiatives will do is

support innovation which focuses on real consumer benefits, whether in terms of product performance, price or service. It will limit the ability of competition to lead to features and modifications which are likely to damage the credibility of the product. It is interesting to see signs that this change in approach is already starting to happen, with the ABI and IMA announcing initiatives last week to self-regulate the naming of funds, so that the risk profile is better understood by the customer. I never expected an industry body to propose renaming a "Cautious Managed Fund" as a "Mixed Investment: 20-60 percent shares". Yet this is what the ABI has proposed. According to their research² among consumers in the target group the effect has been to change expectations about the riskiness of this type of fund from 10% of people thinking it was medium to high risk to 60%. Describing products in a way consumers understand is a big step towards helping consumers choose suitable products and reducing the possibility of mis-buying. This is exactly the sort of industry initiative designed to create realistic expectations that the new regulator should continue to encourage.

I am hoping that the debate which the FSA has recently initiated on the role of product intervention and the work the industry has been doing on the development of simplified advice will come together to help fill the advice gap which has opened up for people in the middle market and which will be exacerbated by the changes being introduced by the RDR.

You will gather from what I have said so far that the Panel wants to see the FCA building on the FSA's recent initiatives to encourage better conduct by expecting better behaviour using, if necessary, the information which it holds about individual companies to provide a reputational nudge to improve behaviour. Enforcement will always be a necessary threat, but we hope that it will not need to be employed so much in future to deliver the very significant amounts of redress we have seen in the recent past. If this continues to be necessary, I think it will be evidence of a failure of the regulator as much as the industry.

The key limitation on effective enforcement in FSMA is section 391 which prevents the publication of warning notices. The Panel believes that the warning notice, the FSA's equivalent of a formal charge should be publicised. Consumers must surely have the right to know at the earliest opportunity that a firm or an individual is under investigation. They would in other fields of life. The particular problem with financial services is that enforcement action can take literally years to complete. Consumers, kept in the dark by the present arrangements, can continue to suffer detriment, buy products or enter into contractual relationships with firms under investigation for the most serious allegations. Meanwhile the cost of redress continues to rise. This would not be the case with a construction company being prosecuted for health and safety violations, a chemical firm under investigation for environmental breaches or a politician facing criminal investigation over his expenses. So why should this secrecy be preserved for financial services providers? It is surely in everyone's interest for the process to be as swift and efficient as possible.

This leads to the final point I would like to make about the implications for business conduct. Improving the financial capability of consumers is essential if we are to help people take better decisions about their finances. Like many people, I have been impressed by the way the other FSA, the Food Standards Agency has shifted the public conversation about healthy eating by talking about five portions of fruit and vegetables per day. Diet is very complex. It's almost impossible to give specific advice at a general level without misleading some people. Yet,

the food industry has found a way to sensitise people to the need to behave well and to encourage them to think about improving their diet without frightening them. The FCA will be responsible for CFEB and it is important that industry moves to support their very basic educational initiatives with consistent messaging. Education of the consumer is part of the marketing activities of most organisations, industry and the regulator need to think about how to create healthier financial behaviours in the population and act together.

The Consumer Panel's five things the FCA needs to deliver to be a success

So, to sum up; to be a successful regulator the FCA must learn from the FSA's mistakes. The Panel believes that there are five key criteria on which the FCA will be judged.

Firstly it is crucial that the FCA gives adequate weight to consumer protection in its work. The FCA must work closely with CFEB to ensure that consumers have the knowledge they need with regard to financial services. It must also take a lead in ensuring that the industry brings forward safer products and simplified advice structures. We have long made the case for simplified advice, perhaps delivered through computerised decision trees to allow consumers to be directed towards suitable products. It is clear that although there is enthusiasm in some quarters of the financial services industry it will take leadership from the regulator to ensure that this happens.

Secondly, it follows that the FCA must be more proactive and effective than its predecessor. There are issues here on two levels. The FCA must have the powers it needs to carry out its role, through means such as temporary product bans, advertising bans and tough enforcement action. It must also be able to use, transparency to encourage better behaviour. The sections of FSMA which currently prevent the disclosure of information or the publication of warning notices must be repealed in the forthcoming legislation. With the Internet and social media we have entered a new era of where it is no longer possible to manage the information consumers receive. Transparency builds trust and introduces objectivity. This is something which the Government should reflect upon and embrace in the new regulatory structure.

Thirdly, the FCA also needs to be able to assert itself in the new structure. It would be a mistake if the faults in the present regulatory structure were replaced by a new flaw, that of a powerful and unaccountable Bank of England. The FCA must not therefore end up as a subsidiary or a subordinate of the bank.

Fourthly, the FCA must make effective competition a key tool in its arsenal for improving financial services regulation. There are important lessons from other areas of regulation on the benefits of effective competition.

Finally, there must be effective consumer representation in the FCA and in the PRA and Bank of England. There is a risk that the balance of power in the new structure will shift towards the Bank of England. Given the potential for macro-prudential tools to cause significant detriment to specific groups within the population if not introduced thoughtfully, there must be adequate consumer representation to ensure that conflicts can be resolved between the Bank and other parts of the regulatory system. You only have to think of the mortgage market where decisions made on a prudential basis could have profound consequences for consumers and Government alike, if a decision was made to heavily restrict mortgage lending for example.

I think the FCA could herald a fresh start for consumer protection in the UK. However, this will only happen if we get the legislation right. To be fair to the FSA it was operating in a very different political environment until relatively recently and it has changed its behaviour over the last two years, but there is still an opportunity for the FCA to become a more effective regulator providing better protection for consumers and markets where firms who meet genuine consumer needs can prosper.

Thank you very much for listening

¹Consumer Perceptions of Fairness Within Financial Services – Opinion Leader and Consumer Panel June 2010

² New names for the Mixed Asset Sectors - ABI Research Paper No 27, 2011