

Telephone: 020 7066 9346
Email: enquiries@fs-cp.org.uk

Cosmo Gibson
Conduct Policy Division
Financial Services Authority

31 July 2012

Dear Cosmo

CP12/9* Consumer redress scheme in respect of unsuitable advice to invest in Arch cru funds**

This is the Financial Services Consumer Panel's response to CP12/9** covering proposals to establish a consumer redress scheme in respect of unsuitable advice to invest in Arch cru funds.

Executive summary

The Panel strongly supports the work undertaken by the FSA to consider how best to deliver redress to the significant number of consumers that were inappropriately advised to invest in Arch cru funds. We believe there were multiple and widespread failures in the Arch cru scandal which has led to up to 20,000 consumers suffering detriment. These failures include the significant number of advisers providing unsuitable advice to their clients about whether to invest in these funds.

The Panel supports the FSA's intention to set up a Section 404 consumer redress scheme. We believe the Section 404 powers are ideally suited to tackling this type of market failure and feel the costs of establishing this scheme are proportionate to the consumer benefits it will deliver. Furthermore, we consider this to be the only viable option to ensure all consumers that were badly advised in this instance receive the redress they are due.

However, we urge the FSA to seek to extend the deadline for consumers to make a separate claim against the CF Arch cru payment scheme. We believe there are significant consumer benefits in ensuring this scheme remains open to new claims while the proposed Section 404 consumer redress scheme is also running. This includes raising awareness of the need to register a separate claim against the CF Arch cru payment scheme in advisers' communications with their client. This is especially important as any redress paid under the Section 404 consumer redress scheme would be over-and-above, and not instead of, compensation that would be due from the CF Arch cru payment scheme.

The Panel also encourages the FSA to undertake a review of the redress scheme once it has concluded in mid-2012. Given this is the first time the FSA has used the Section 404 power, we believe it is important to retrospectively assess the success of the scheme. We suggest the review should consider:

- whether the FSA's use of the power was reasonable and appropriate;

- whether the scheme delivered redress to all consumers that were inappropriately advised to invest in an Arch cru fund; and
- the impact this had on firms, particularly the smallest advisory firms, who after undertaking a review of their files found they met all necessary standards.

Detailed questions

Q1: Do you agree with our analysis of the risks of the Arch cru funds and the implications of this for advisers?

and

Q2: Do you have any comments on the file review?

The Panel supports the FSA's analysis of both the risks associated with the Arch cru funds and the standards advisers should have met when recommending these investments. We applaud the thoroughness of this analysis and strongly approve of the decision to commission a specialist statistician to develop a sample design for the file review. We would like to see the FSA adopt this approach in other areas of its work.

Having reviewed the findings of the file review, the Panel is alarmed by the number of advisers that relied on marketing information and high-level labels when advising consumers to invest in these funds, rather than seeking to understand the underlying risks to their clients' capital. This has undoubtedly led to widespread mis-selling of these investments, and more worryingly, other investments which has not yet come to light.

It is of little comfort to the majority of consumers that were mis-sold these investments that a small minority of advisers were able to meet the most basic standards and provide suitable advice on the Arch cru funds. The fact that some advisers undertook appropriate due diligence when advising on these investments demonstrates the sub-standard service a significant number of consumers received from the remainder. For this reason, the Panel is extremely supportive of the steps the FSA proposes to take to ensure consumers, that were inappropriately advised to invest in Arch cru funds, are adequately compensated.

Q3: Do you have any comments on our assessment of the losses experienced by consumers as a result of unsuitable advice to invest in Arch cru funds?

The Panel welcomes the steps the FSA has taken to undertake an assessment of the losses experienced by consumers as a result of unsuitable advice to invest in Arch cru funds. The Panel has no specific comments on this analysis, but are deeply concerned about the failures the assessment identifies. In particular, we are astonished that 10% of consumers advised to invest in these high risk investments should not have been advised to take any capital risk at all.

Q4: Do you agree with our assessment of the options available for delivering consumer redress?

The Panel agrees with the assessment of the options available for delivering consumer redress and firmly believes establishing a Section 404 consumer redress scheme is the best option.

Both option 1 (supervisory action on a firm-by-firm basis) and option 3 (reach an agreement with firms) fail to ensure that all consumers that received unsuitable advice receive redress. Given the number of advisory firms that potentially wrongly advised consumers to invest in an Arch cru fund, we believe industry-wide action, rather than firm-by-firm agreements, is the only viable solution to ensure consumers are appropriately compensated.

Likewise, the Panel feels that neither option 2 (issue guidance on complaints handling to firms) and option 4 (issue a call to action to consumers) are credible solutions. Both rely on consumer action, which as past experience has shown, often means consumers do not receive the redress they are due. We note from the FSA's own analysis, neither option is likely to deliver compensation to more than 30% of investors, which the Panel considers to be unacceptably low. Indeed, we understand claims against the CF Arch cru payment scheme, a separately established scheme to compensate investors, has been lower than anticipated.

The Panel recognises that establishing a Section 404 scheme is the most expensive potential solution, but given the levels of consumer detriment and wide-spread mis-selling, we consider these costs to be proportionate to the consumer benefits. We also recognise that this scheme will burden the small number of advisory firms that provided suitable advice on these funds.

Q5: Do you agree with our assessment that the legal tests for making a consumer redress scheme have been met?

Having reviewed the FSA's analysis, we believe the FSA's actions are consistent with the guidance GN10 which sets out the FSA's process for establishing a consumer redress scheme.

Q6: Do you agree with our proposed principles and scope, including our interpretation and application of the relevant laws?

The Panel agrees with the proposed principle and scope of the consumer redress scheme. In particular, we strongly welcome the proposal to require advisory firms that are no longer authorised to comply with these requirements. As we have outlined in our response to question 4, we consider it essential that all consumers receive redress where they were inappropriately advised to invest in an Arch cru fund. This should include customers of firms that have had their permissions cancelled.

However, the Panel is concerned that the proposed consumer redress scheme will only become operational after consumers have lost the right to make a claim against the separate CF Arch cru payment scheme ('payment scheme'). We therefore strongly urge the FSA to seek to extend the deadline to register a claim against the payment scheme beyond 31 December 2012 so that it coincides with the end of the proposed consumer redress scheme. This would allow the standardised letters advisory firms send to their clients to better explain the difference between the two programmes. The letter could also remind consumers that they need to separately register a claim against the payment scheme, as any compensation payable under the consumer redress scheme would be in addition to (and not place of) that particular claim.

Q7: Do you have any comments on the implementation of the proposed scheme?

and

Q8: In particular, do you have any views on our proposed approach to calculating redress in relation to taking account of the value of the residual assets of the funds, and payments available to consumers under the CF Arch cru payment scheme?

The Panel believes that effective communications with consumers is going to be a crucial element of this scheme. This includes ensuring that consumers:

- are clear about the scope of the scheme, what is required of them and how the process will operate;
- can easily understand the difference between this scheme and the CF Arch cru payments scheme;
- are clear about what additional information they should provide, where it is required; and
- are clear that they have the right to complain or take forward legal action against a firm even if they are assessed as being outside the scope of the scheme.

For this reason, the Panel strongly supports the FSA's proposal to require advisory firms to use a standard template letter when contacting consumers. Equally, we support the FSA's intention to require firms to follow a defined process when assessing whether a consumer received unsuitable advice to invest in an Arch cru fund and, where mis-selling has been identified, provide an online calculator to assess the amount of redress to be paid. The Panel applauds this approach as a means of ensuring the redress scheme is implemented consistently across all firms and for all consumers. However, it is important that the FSA checks firms' are following this process correctly, as there may be a motivation for some firms to avoid paying compensation, especially where this may create financial difficulties for the firm.

The Panel also supports the intention to encourage consumers that have not received a letter from their advisory firm within four weeks of the start of the scheme to report this to the FSA. This will enable the FSA to investigate whether a firm is failing to comply with the requirements of the regime or simply put the two parties in contact where the firm does not have up-to-date contact details for the consumer. For this to be successful, we consider it essential for the FSA to raise awareness of the scheme, so consumers that have invested in an Arch cru fund know to expect a letter from their advisory firm.

The Panel accepts, for the reasons outlined in the consultation, that it may be appropriate in some circumstances to allow advisory firms flexibility when calculating the amount of redress which should be paid under the proposed consumer redress scheme. However, given this potentially leaves the scheme open to abuse, we urge the FSA to monitor closely the redress paid by firms that have independently calculated the amount of redress due. We imagine the proposed reporting requirements would be the ideal mechanisms for capturing this information.

Q9: Do you have any comments, or evidence or analysis to add, on our cost-benefit analysis?

The Panel does not have any additional data to help refine the cost benefit analysis. However, we want to reiterate our comments set out in question 4 that, although the costs of establishing a Section 404 consumer redress scheme are greater than the alternative options for delivering consumer redress, we believe these costs are proportionate given the widespread consumer detriment suffered as a direct consequence of unsuitable advice to invest in the Arch cru funds.

Yours sincerely,

Adam Phillips
Panel Chair