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Future Regulatory Framework Review
Financial Services Strategy
1 Horse Guards Road
HM Treasury
London SW1A 2HQ

19 February 2021

By email: FRF.Review@hmtreasury.gov.uk

Dear Sir / Madam,

Financial Services Consumer Panel response to HM Treasury future regulatory framework phase II consultation

The Financial Services Consumer Panel is an independent statutory body. We represent the interests of individual and small business consumers in the development of policy and regulation of financial services in the UK. We wish to be clear from the outset that when we refer to 'consumers' below, we refer to both individuals and SMEs. Likewise, when we comment on the regulatory framework, we comment on how it applies to both individuals and SMEs.

We welcome the opportunity to comment on HM Treasury's proposals for the future regulatory framework. Ultimately, we believe financial services regulation should ensure that consumers are served in accordance with their best interests. This means that:

- Firms act in consumers' best interests.
- Firms which do not, or are unlikely to, act in this way should not be admitted to the market. If they are already in the market, they should be robustly sanctioned or barred.
- Consumers know when they are (and are not) protected and what "protected" means.
- Consumers are protected from new and emerging harms because regulation keeps up with technological change and regulators have the ability to act swiftly.
- Consumers get prompt and commensurate redress when firms don't meet the best interests standard.
- Innovation is supported and encouraged insofar as it benefits consumers. New products and services should be appropriate and come with suitable protections.
- Regulation recognises the wider socio-economic and demographic context it exists in. This includes the diversity of consumers' lives, their relative skill and knowledge compared to firms, the complexity of products available to them, and the impact of non-financial policies on them.

These outcomes are entirely consistent with a strong financial services market that earns and retains the confidence of consumers and investors, and is attractive to firms across the world. Therefore, in achieving these outcomes, HM Treasury will also achieve its own objectives for the future regulatory framework review and support the UK's economic recovery from the coronavirus pandemic.

To be clear: we do not think these outcomes are being achieved at the moment and the coronavirus pandemic has only made this more apparent. We have heard that consumers are being asked to pay the same – or more – for insurance that offers them less cover than before¹. Cynically targeted digital advertising continues to reach consumers at a time when, for many, new vulnerabilities have arisen and existing vulnerabilities are heightened². This means that when markets begin to recover, there is a greater risk of consumers using unsuitable products to get out of debt or investing in products that are unsuitable for them. We are concerned that banks have treated SMEs poorly by adding unreasonable barriers to accessing vital government support³ and exploiting new lending relationships for commercial gain⁴. And all the while new products are popping up – some within the regulatory perimeter, others outside it; some bringing genuine benefit for consumers, others seeking to exploit them. Regulation is playing catch up to poor practice, technological change and financial innovation. Meanwhile, consumers are suffering harm.

On the questions at the centre of the consultation:

- We support improved scrutiny and accountability in the regulatory framework. We're cautious about creating new agencies and processes, but **the consumer voice does need to be hard-wired into every part of the framework** to correct the huge imbalance of representational resources the industry currently enjoys which directly impacts on market inefficiencies and consumer detriment, as identified above.
- We are open to the independent Panels, including ourselves, being more open and transparent in how we work. Our statutory responsibility is to provide early scrutiny and challenge on regulatory ideas at a formative stage: this role is essential and should continue. We welcome views of other stakeholders on how we can improve our own ways of working and would welcome the opportunity to participate in Parliamentary and other scrutiny processes, as long as this does not damage our ability to act as a 'critical friend' to the FCA.
- We think **regulatory duties and objectives should be re-visited** as part of this review. The hierarchy of objectives and "have regards" in legislation, which would be increased by activity-specific principles, creates complexity across the regime, and makes it more difficult for regulators to focus on their paramount function of protecting consumers by ensuring markets work in their interests.

To develop this third point, **the cornerstone of a regulatory framework which addresses these problems and achieves the outcomes above is a duty of best interests**. We set out more detail of what we mean by this in our response to Question 2 below. Fundamentally, we believe there should be duty of best interests enshrined in primary legislation, from which all other regulatory objectives, principles and powers flow. In the meantime, we believe that the FCA should be encouraged to:

- authorise firms more discerningly;

¹ For example, in travel insurance: <https://www.travelweekly.co.uk/articles/395992/which-demands-probe-into-travel-insurance-covid-cover> and in health insurance: reported to the Panel that health insurance premiums have been maintained or increased, despite the coronavirus pandemic preventing full cover being provided as all elective operations were cancelled for a prolonged period.

² <https://www.fca.org.uk/publications/research/financial-lives-2020-survey-impact-coronavirus#lf-chapter-id-the-impacts-and-experience-of-covid-19-consumers-with-characteristics-of-vulnerability>

³ One instance of public note was with Clydesdale: <https://www.gov.uk/government/news/cma-stops-clydesdale-bundling-business-accounts-with-loans>. Also reported to us from our own networks are instances of SMEs being asked to use personal assets as security to access the support schemes, despite the government guarantee.

⁴ <https://www.fca.org.uk/publication/correspondence/dear-ceo-ensuring-fair-treatment-corporate-customers-preparing-raise-equity-finance.pdf>

- supervise firms more vigorously; and
- use its extensive powers to enforce and correct market failings more rapidly.

The FCA's prompt and effective actions in response to the coronavirus pandemic have shown that it can be fleet of foot when it needs to be. We strongly believe faster responses to emerging consumer harms are something the FCA should be encouraged to deliver, and an adapted regulatory framework which is focused firmly on protecting the consumer will allow them to do this with greater confidence.

Our responses to the specific questions are included at Annex A.

Yours sincerely,

Wanda Goldwag
Chair, Financial Services Consumer Panel

ANNEX A – Responses to questions

Q1. How do you view the operation of the FSMA model over the last 20 years? Do you agree that the model works well and provides a reliable approach which can be adapted to the UK's position outside of the EU?

The intentions of the FSMA framework have largely been delivered in practice, but the model has at times proved not to be nimble enough to adapt at speed to new risks and head off firms, products and services that may cause consumer harm. The sternest criticisms of regulators and Government have arisen when consumers have suffered harm. We believe the review should aim for a regime with a simpler, clearer focus on consumer protection, and enhanced consumer representation in scrutiny and accountability arrangements.

Q2. What is your view of the proposed post-EU framework blueprint for adapting the FSMA model? In particular:

- **What are your views on the proposed division of responsibilities between Parliament, HM Treasury and the financial services regulators?**
- **What is your view of the proposal for high-level policy framework legislation for government and Parliament to set the overall policy approach in key areas of regulation?**
- **Do you have views on how the regulators should be obliged to explain how they have had regard to activity-specific regulatory principles when making policy or rule proposals?**

The Panel supports the proposed division of responsibilities as set out in HM Treasury's consultation. We agree with HM Treasury's observations on the technical expertise of regulators and believe that independence is key to the execution of regulatory functions. It therefore makes sense to transfer a greater degree of responsibility to regulators.

There are a few areas we wish to provide more detailed comments on: the perimeter and the proposal for activity specific principles.

The perimeter

A critical area where responsibility is divided between Parliament, HM Treasury and the regulators is in respect of the regulatory perimeter. There is evidence of significant consumer harm occurring around the perimeter, in three areas particularly:

- **Unregulated activities of regulated firms** – firms regulated for some activities use their regulated status to create an impression of regulation and protection across their whole businesses. A recent high-profile example of this was seen with London Capital & Finance. Government and regulators may wish to consider whether it should be a requirement that regulated financial services firms only sell and promote regulated products. Most importantly, changes must be made to ensure that the operation and visibility of regulation is clear, unambiguous and so obvious that consumers cannot be misled.
- **New products and services which are unregulated, but look very like regulated products and services** – these products and services avoid regulation seemingly on a technicality and some are allowed to grow exponentially with none of the protections associated with being within the perimeter. A current example of this is the unregulated buy-now-pay-later market. We welcome the conclusion of the Woolard Review to bring these products within the perimeter⁵, but there is

⁵ <https://www.fca.org.uk/about/woolard-review-unsecured-credit>

still further to go before these firms become regulated. In the meantime, consumers will continue to accumulate problem debt.

Further, some firms may deliberately design their products to avoid the perimeter and therefore avoid the associated regulation. Understandably, products and services which look like, but are not, regulated products cause much confusion amongst consumers, who may mistakenly believe a product or service attracts protections associated with being within the perimeter. This can cause a sudden and unexpected loss of protection for consumers. We strongly support the principle mentioned in the Woolard Review that equivalent regulation and protections should be applied to equivalent products⁶ – and this principle applies both sides of the perimeter.

- **Complexity for SMEs** – the boundary between what is and isn't protected for SME consumers is complex and even less straightforward than for individual consumers. This means that SMEs may end up with an amalgam of regulated and unregulated products, but be unable to distinguish between them. This can result in an unexpected lack of regulatory protection and reduced confidence in the regulatory regime. We are concerned that the SME experience of regulation is not well understood and would therefore strongly encourage HM Treasury to conduct a deep-dive review into SME experiences of regulation and consult on necessary changes to the perimeter.

With these harms in mind, we believe the regulatory perimeter needs to be much more agile and responsive. We believe this is possible within the current framework and support Dame Elizabeth Gloster's conclusions that the FCA should use its existing powers to intervene beyond the perimeter where there are clear red flags – and it should do so quickly⁷. We would also like to see pre-emptive temporary bans on products or practices where it appears such products or practices could cause significant harm to consumers. These bans would be strictly time-limited to give the FCA enough time to ascertain if further action needs to be taken whilst minimising disruption to legitimate business. Using emergency powers such as this would mean that, although Parliament rightly retains responsibility for deciding what is and isn't regulated, regulators have the flexibility to address emerging harm without needing to go through a lengthy legislative process. Consumer harm would be addressed more quickly and therefore ultimately be reduced.

In addition to more agile interventions from the regulators, we would support a wide-ranging independent review of the perimeter according to the following principles:

- Consumers get equivalent protections when engaging with equivalent financial activities, leaving the regulator to distinguish between different business models via their rules.
- Emerging consumer risks are intercepted by agile regulators.
- Consumers get consistent access to redress across products and services.

Activity-specific principles

It is not clear to us what activity-specific regulatory principles would add to the existing framework, or how they would interact with it. Most of the key elements of financial regulation (e.g. financial soundness and transparency for consumers and investors) are not sector-specific and would be better enshrined in universal statutory provisions. In our view, the most fundamental of these would be a single, over-arching 'duty of best interests' whereby firms are required to act in the best interests of their customers. As

⁶ <https://www.fca.org.uk/about/woolard-review-unsecured-credit>

⁷ For examples of such powers, see p98-99 of the [London Capital and Finance report](#). See also the FCA's [perimeter report](#). For Dame Elizabeth's conclusions on the FCA's use of its perimeter powers, see Chapter 6 of the London Capital and Finance Report.

outlined in our covering letter, the current regulatory framework, including Principle for Businesses 6 ('treating customers fairly') which creates only a weak duty, does not always allow the FCA to fulfil its operational objective to protect consumers⁸. Therefore, the bar must be re-set at a level which would ensure consumer harm is minimised – and it is our view that level must be primary legislation. Without setting the bar at an appropriately high level, the FCA's enforcement tools (including the much-vaunted Senior Managers and Certification Regimes), however diligently deployed, will remain ineffective in protecting consumers. We expect the FCA to publish a consultation on their work on a new consumer principle later this year, which will undoubtedly be helpful, but not sufficient given that statutory change is required. **We therefore call on HM Treasury to include consultation on a statutory duty of best interests in the next stage of its work on the future regulatory framework.**

There may be benefit in additional principles that support this duty of best interests. For example, it might be helpful for legislation to confer regulators with specific duties to ensure that the boundaries between adjacent regimes are seamless. This will ensure that intelligence is joined up and consumers aren't left exposed to harm by gaps between regimes. This principle could usefully be applied between the FCA and Information Commissioners office to address harms around consumer data, or between the FCA and the Advertising Standards Authority on financial promotions.

Similarly, HM Treasury could consider introducing principles that clarify the intersection between financial services regulation and social policy. Too often the FCA is put in the position of making social policy judgements, which should be the preserve of Government. That is not to say regulators have no role – we very much support the recommendation in the Woolard Review that the FCA should provide data to Government that shows the impact of social policy on regulated sectors⁹.

Finally, we would encourage HM Treasury to consider whether there is benefit in introducing a principle that more clearly establishes regulators' powers in relation to SMEs. SME interests are often considered secondary or as an afterthought to those of individual consumers and so having an explicit regulatory principle will help bring SME interests to the forefront and ultimately improve their outcomes, in turn supporting economic growth and recovery.

We encourage HM Treasury to ensure they consult on any new regulatory principles with a wide range of consumers, including consumer groups and representatives. They must also include due process for review and evaluation and appropriate safeguards against short-term political expediency.

Q3. Do you have views on whether and how the existing general regulatory principles in FSMA should be updated?

As mentioned above, the Panel believes there should be a duty of best interests and this should be enshrined in primary legislation. All other regulatory objectives, principles and 'have regards' should support this duty of best interests.

This may require updates to existing principles. For example, the consumer responsibility principle (s3B(1)(d) FSMA 2000) could be amended to better reflect the ever-growing asymmetries between firms and their customers and squarely place the onus on firms to act in a way which is clear and fair. This change is becoming all the more necessary given the ongoing transition to digital products and services. For most – though crucially not all

⁸ Further prominent examples include the loyalty penalty in insurance, PPI misselling, and banks responding to the FCA's new overdraft rules preventing them charging more for "unarranged" overdrafts by putting "arranged" overdraft interest rates up to as much as 40%.

⁹ <https://www.fca.org.uk/about/woolard-review-unsecured-credit>

– digital products and services are easier to access; but we are concerned about transparency, suitability and redress issues. Overall, the balance of power shifts ever more in favour of firms and the financial services market, and consumers become further disadvantaged.

There may also be new principles needed to support the overarching duty of best interests, such as a financial inclusion principle. We have co-signed letters to Mr John Glen MP and Mr Mel Stride MP on this important issue. Please refer to these letters for the arguments in full.

The Panel would welcome working with HM Treasury and regulators to explore what further changes may be required to facilitate and support a duty of best interests.

Q4. Do you have views on whether the existing statutory objectives for the regulators should be changed or added to? What do you see as the benefits and risks of changing the existing objectives? How would changing the objectives compare with the proposal for new activity-specific regulatory principles?

We believe the current statutory objectives remain broadly fit for purpose, though amendments might be required to support our proposed duty of best interests.

We recognise the arguments for and against a statutory competitiveness objective set out in HM Treasury’s consultation paper. We are unconvinced of the merits of this objective. The FCA already has a competition objective and adding a competitiveness objective in addition to this risks diluting their critically important consumer protection objective. Competition within markets, and the competitiveness of markets, should not come at the expense of consumer protection. If others continue to push for a statutory competitiveness objective then we recommend that HM Treasury promote further debate to fully explore its implications.

Q5. Do you think there are alternative models that the government should consider? Are there international examples of alternative models that should be examined?

No comment.

**Q6. Do you think the focus for review and adaptation of key accountability, scrutiny and public engagement mechanisms for the regulators, as set out in the consultation, is the right one? Are there other issues that should be reviewed?
AND**

Q7. How do you think the role of Parliament in scrutinising financial services policy and regulation might be adapted?

We believe that current accountability and scrutiny arrangements are broadly sufficient. The regulatory remit letters, supplemented by informal processes and consultation work adequately and ensure clear accountability for regulatory outcomes. The key to making the current arrangements work most effectively is to enhance transparency as much as possible. We commend the FCA for its extensive public consultation as part of its policy making processes. This ensures a wide range of stakeholders have the opportunity to input into key areas of financial regulation.

Below, we comment on some of HM Treasury’s specific proposals around accountability and scrutiny.

Role of the Panels

We see ourselves as a 'critical friend' to the FCA – we support and encourage them when we think they've got it right; but we don't hesitate to challenge them where we think they've got it wrong, missed a point or taken a wrong turn. In doing so we help to scrutinise the FCA and challenge them on their delivery against their statutory objectives, particularly to protect consumers. Overall, we believe the role of the Panel works well in its current form, though we are open to making some improvements and challenging ourselves to improve our connections with other consumer interest groups. In making these comments we refer only to the Consumer Panel; the other Independent Panels have submitted their own responses to this consultation.

In terms of improvements, we are considering how to raise the profile of the Panel, both within and outside the FCA. We also see a role for greater engagement between ourselves and HM Treasury. This could take a similar form to our engagement with the FCA; with HM Treasury discussing policy proposals with us at an early stage. For example, we really appreciated the opportunity to discuss the future regulatory framework consultation with HM Treasury before submitting this formal response.

In terms of accountability of the Panel, we welcome being held to account for our processes (including recruitment), our performance and the advice we give. We cannot, however, be held to account for regulatory outcomes or how our advice has been used (or not) by regulators. On this final point, we would propose that the FCA be required to more systematically explain how it has taken account of our advice and challenge, even if this has not resulted in action and similarly, we would like to see the same with HM Treasury.

Additional independent scrutiny

We would caution against any additional layers of scrutiny, such as the further independent panel and independent reviews outlined in the consultation paper. We would prefer that existing independent processes were strengthened and used more systematically. For example, we would welcome the consideration of:

- An expanded role for the Regulatory Policy Committee to cover the actual costs and benefits of regulatory interventions after their implementation, including a sample of measures below the current £5 million impact threshold.
- A fuller role for the National Audit Office in evaluating regulatory policy-making processes and how regulatory outcomes are estimated and monitored.
- A stronger requirement on the FCA to spell out the outcomes it expects and to measure and report progress towards them.

Parliamentary scrutiny

We note HM Treasury's reference to amending Parliamentary scrutiny arrangements, and agree that it is for Parliament to decide what these should be. It is difficult for us to comment without seeing specific proposals, however, any scrutiny arrangements must include sufficient consumer representation and be adequately resourced. We comment fully on consumer representation in answer to Q9 below.

Q8. What are your views on how the policy work of HM Treasury and the regulators should be coordinated, particularly in the early stages of policy making?

We support systematic early engagement between HM Treasury and regulators on substantive regulatory proposals. It is important that HM Treasury and the FCA can be held accountable for their respective roles in the nature and speed of policy decisions and for this to happen it must be clear what these roles are. This is especially important in instances where the FCA and HM Treasury disagree on a proposed course of action. We would once again emphasise the importance of transparency in policy making.

Engagement between FCA and HM Treasury should be subject to statutory safeguards for regulatory independence and emergency intervention powers (as covered under Q2 above). This protects regulators from undue political interference, which could lead to instability for firms and consumers.

Q9. Do you think there are ways of further improving the regulators' policy-making processes, and in particular, ensuring that stakeholders are sufficiently involved in those processes?

Consumer representation

We believe there is a need for more and better-quality consumer representation in the financial services system. Without this, regulation simply won't work for consumers. Industry stakeholders have a strong voice, both as individual firms and when they come together via trade bodies¹⁰. They also have a lot more resources at their disposal to fund lobbying activities and convene interested parties when needed. The consumer voice is comparatively weaker and more disparate, and unfortunately consumer representation is too often regarded as token. There should therefore be more opportunity for consumer representation in policy making and legislative processes to help balance the stakeholder input. To help achieve this, good consultation practice could standardise

- (a) the inclusion of more ways to respond, including streamlined approaches, to elicit consumer input;
- (b) direct research and engagement with impacted groups; and
- (c) more specific feedback on its response to consumer views.

There could also be a stronger consumer voice in industry, via firms' own governance procedures. This could include requiring firms to demonstrate how they have sought to incorporate the consumers' voice into their strategies, or proactively inviting challenge from consumer representatives when setting the strategy and business plan for the firm (an approach used in the water sector).

Cost-benefit analyses

We believe that regulators should make more effective use of cost-benefit analyses in their policy-making processes. Currently, the FCA only publishes a cost-benefit analysis on the policy option it has chosen to pursue. In the interests of transparency, we would encourage the FCA to publish high level cost-benefit analyses on several possible interventions. This should include an estimate of the costs of potential interventions compared to an estimated net present value of the outcomes (e.g. the amount harm would be reduced by). This would help the FCA more clearly demonstrate how it is meeting its statutory objectives, as well as other obligations, such as the FSMA principles. It would also facilitate full and robust challenge from stakeholders and independent scrutiny functions, which will ultimately lead to better decision making.

Evaluations

We'd also like to see regulators and government making better use of the evaluations process to feed lessons learned back into the system and ultimately improve future policy making. The FCA has an established evaluation process but these are large-scale, complex projects that take a significant amount of time. The FCA tends to only do one evaluation per year, when it makes policy much more often than that, the impact of which can be

¹⁰ For example, note the number of industry bodies that met with HM Treasury in 2020. There are no consumer organisations listed. See: https://www.gov.uk/government/collections/senior-officials-expenses?utm_medium=email&utm_campaign=govuk-notifications&utm_source=36c57e57-f72a-45bb-82d3-f5c430465758&utm_content=daily#2020

near-instant. For example, when the FCA introduced new rules on overdrafts¹¹, it set a review date but then had to intervene well before this date as firms almost immediately increased prices. We would like to see the FCA evaluating a greater proportion of its work which could mean a shorter, more focused evaluation process that prioritises assessing impact of the policy on consumer harm. This quicker approach could be facilitated by the FCA collecting early data to monitor how things are progressing against its expected outcomes (outlined in the cost-benefit analysis).

¹¹ <https://www.fca.org.uk/publications/policy-statements/ps19-16-high-credit-review-overdrafts>