Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

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Dear Sir / Madam,

Our framework: Assessing Adequate Financial Resources

This is the Financial Services Consumer Panel's response to the consultation on assessing adequate financial resources.

When firms do not have adequate financial resources at the point where they go out of business consumers can experience potential devastating harm as unsecured creditors. FSCS coverage will sometimes apply, but this has limits which can sometimes be insufficient to compensate consumers fully, for example depending on the size of an individual's pension fund or the product they have bought.

If firms have resources to match their risk, there should be fewer disorderly firm failures, with lower costs required to be paid by the industry via the FSCS levy. The costs for FSCS levies are, of course, ultimately borne by consumers. For this reason, we are supportive of the FCA providing clarity on what constitutes adequate financial resources.

The level of resources a firm needs should be proportionate to its risk profile. The riskier, the firm, the higher capital buffer they should have on their balance sheet and this includes appropriate third-party insurance to compensate consumers when things go wrong.

The board of a firm should demonstrate that it regularly reviews financial resources against risk appetite and that it has appropriate reporting and management information to allow it to do so. We believe that firm culture, robust controls and governance play key parts in managing the risks that determine what constitutes adequate resources. The FCA's ability to assess this will be very much driven by the approach taken by executives and the board. It is our view that more diversity on firm boards will improve the likelihood of robust challenge in regularly assessing whether a firm has adequate resources to support its risk appetite.

It is also imperative that the firm demonstrate strong internal financial controls, internal audit and independent auditors.

Wonga's inability to cope with the number of compensation claims it was paying out, is an example of a firm's risky business model and insufficient financial resources to cope with the claims, causing detriment to the consumers it is meant to serve.

Q1: Do you agree with our proposed Consultation Paper text clarifying the purpose of adequate financial resources and our approach? If not, please explain why.

While we agree with the FCA clarifying the purpose if capital resources, it should be borne in mind that consumer protection is only assured if firms actually hold those adequate resources.

Q2: Do you agree with our proposed Consultation Paper text clarifying what we look for from firms when assessing adequate financial resources? If not, please explain why.

We believe further clarity would be useful, particularly in relation to the consumer credit sector, on the role of capital in making firms more resilient against big spikes in complaints. There should be a requirement for Boards to scenario plan for fast-changing risks when they set their

liquidity and capital strategies. Furthermore, it would be useful if the FCA made statements about orderly wind up and relevant future scenarios a compulsory part of initial public offering (IPO) prospectuses. This would align the risks of pre-IPO owners, new investors and customers over the lifecycle of the business.

Q3: Do you agree with our proposed Consultation Paper text clarifying our expectations as to the practices firms should adopt in their assessment of adequate financial resources? If not, please explain why.

There are severe weaknesses in the requirements surrounding when accounting rules require firms to set aside money to cover potential redress to consumers. The Bank of England has said that "Accounting rules require provisions to be raised where an obligation exists only once settlement is considered probable and where a reliable estimate of the amount can be made". This means that potential costs of misconduct can be far in excess of accounting provisions.[1]

Experience has shown that for a variety of different reasons, firms may underestimate the potential liabilities from misconduct, consumer complaints or redress. For example, in assessing their liability from potential complaints, Wonga assumed a time limit for complaints which did not take into account the actual DISP rules on time limits or how they could be interpreted.[2] Banks and other firms have under-estimated the costs of misconduct from PPI and packaged bank accounts and had to increase provisions on many occasions.

In assessing adequate financial resources, the FCA should require firms to understand the misconduct costs which could occur in stressed conditions, including a spike in complaints or the imposition of a redress scheme. It should clarify that this stress scenario should be in excess of existing accounting provisions. Firms should be able to provide and document quantitative and qualitative information to support material assumptions underlying their stressed projections of misconduct costs. For example, where future customer redress is estimated using statistical data, banks should provide details of the volume and value of past business written, the proportion of business that the bank expects to pay redress for, and the average expected value of redress. Firms should undertake a sensitivity analysis and identify any material risks which could cause the costs to exceed their expectations.

Where firms have insufficient financial resources to cover misconduct costs in the stress scenario then they should be required to consider restrictions on paying dividends to shareholders or bonuses to staff.

Q4: Do you agree with the costs and benefits we have identified? If not, please explain why.

No Comment

Yours faithfully

Wanda Goldwag
Chair, Financial Services Consumer Panel

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[1] Ref: https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-report/2018/november-2018

[2] Ref: Page 8 https://turnkeyinsolvencyservices.biz/Viewer/pdfViewer.aspx?sid=rbdj4u20l5lc5wm5l0152xy4&did=f3564dea-79be-44ff-8828-278d2b9eca14 - Note that Wonga was estimating redress based on a six year cut off for complaints whereas the actual DISP rules are the longer of six years or 3 years from when the customer was aware (or ought reasonably to have become aware) that they may have cause for complaint