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

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Dear Sir/Madam,

FCA Mission

The Financial Services Consumer Panel welcomes the opportunity to respond to this consultation.

We believe the Mission is a real opportunity for the FCA to do more to prevent poor conduct, rather than address detriment that has already occurred Preventative tools might include an interrogation of business models, to identify good and bad conduct within firms; and using intelligence and 'radar' to intervene early.

The regulatory principles, set out in Section 3B of FSMA, mitigate against effective consumer protection, as they require the FCA to have regard to consumer responsibility but not to whether firms are treating their customers fairly. The onus on firms implied in the regulatory principles is purely one of compliance with the FCA's rules. The FCA has to define poor conduct and make rules about it. So firms' unfair treatment of consumers continues to be widespread and takes many forms, as we illustrate in the annex. And the rulebook gets longer and more detailed as the FCA constantly plays 'catch up'.

This is the core of our argument for a duty of care. A legal duty would put the onus on firms to avoid conflicts of interest and treat customers fairly. It would be preventative – no firm subject to a legal duty of care would have sold PPI in the way it was sold – and, in time, reduce the need for detailed rules. If the FCA does not want to ask for legislative change, we strongly believe it needs to set out how it will eliminate conflicts of interest between provider and customer, and resolve long-standing unfair practices.

We also believe the FCA needs to be more transparent, to give clarity to firms and consumers alike; and bolder in intervening early, rather than letting detriment continue while it does more analysis and issues more guidance.

Finally, we think the FCA needs to take more of a leadership role in raising public policy issues. Brexit is absorbing a huge amount of government policymakers' time and energy. Many important issues will go unresolved unless the FCA promotes solutions.

Yours sincerely

Sue Lewis
Chair, Financial Services Consumer Panel

Responses to questions:

Q1: Do you think our definition of a well-functioning market is complete? What other characteristics do you think we should consider?

A market that works well for consumers should have the following characteristics:

- Firms compete on the basis of the quality and value of their products or services rather than exploiting consumers' behavioural biases;
- Consumers have access to products that meet their needs and offer value-for-money;
- Consumers are able to compare the price, quality and characteristics of different financial products and firms;
- Products do not include hidden charges or unfair contract terms;
- There are low barriers to market entry and exit (while preserving essential services for consumers);
- There are low barriers to switching (both real and perceived); and
- Consumers are able to pursue effective and speedy redress where necessary.

The Panel's as yet unpublished research into the extent to which consumers can reasonably be expected to drive competition has highlighted consumers' ambivalence to financial services. Many consumers have told us there is too much jargon, small print and choosing products and services is too time consuming and difficult. These problems are familiar and long-standing. Unless they are fixed we cannot hope to have a well-functioning market.

Q2: Do you think our approach to consumer loss in well-functioning markets is appropriate?

Yes, but the FCA needs to be clearer about the distinction between 'no fault' loss (e.g. the consumer buys an investment product that loses value because of market fluctuations) and cases where, for example, a firm sold an unsuitable product or did not properly check affordability. In the latter case, the FCA should ensure that interests are properly aligned so that when consumers lose, so do shareholders and senior executives within firms, by way of meaningful financial penalties and loss of bonuses through malus and clawback.

Q3: Do you think we have got the balance right between individual due diligence and the regulator's role in enforcing market discipline?

We believe the Mission places too much emphasis on consumer responsibility, which relies on consumers being able to make well-informed decisions based on information that they can understand and trust. The onus should not be on consumers to make sense of complex and confusing information, it should be on firms to explain their products and services clearly and simply, and ensure customers have understood. We know that firms are not treating customers fairly in a number of areas and that they can exploit behavioural biases. Examples of where TCF is failing customers, but where firms have not broken FCA rules, are included as an annex.

Q4: Do you think the distinction we make between wholesale and retail markets is right? If not, can you tell us why and what other factors you believe we should consider?

Generally we agree with the distinction made. However, business-to-business transactions do not always involve more sophisticated customers. Existing consumer protections often treat individual consumers of financial services differently from small business consumers.

We would like to see the FCA carry out a segmentation of SMEs, similar to that which it has developed for individual consumers. This should explore the differences between

businesses of different sizes, and whether there are specific issues relating to different ways of conducting business (e.g. sole trader, partnership or limited company).

In an ideal world appropriate consumer protection should be available to all who need it. The Panel believes that deeming a firm to be 'sophisticated' is not appropriate at least until a firm is large enough to employ a professional finance officer or accountant. This cannot be defined by turnover, or number of employees, as it will depend on the type of business.

Q5: Do you think the way we measure performance is meaningful? What other criteria do you think are central to measuring our effectiveness?

We support the ambition to "clearly define how we want a sector to improve in the short and long term and how we will measure outcomes". We do not feel that this is currently the case. Holding the FCA to account requires stakeholder consensus as to how this should be done.

We would suggest the following for each sector the FCA regulates:

- An articulation of what "good" looks like, linked to the FCA's statutory objectives;
- A clear description of how and when "good" is to be measured; and
- The publication of a baseline against which progress should be judged, including consumer satisfaction measures.

We believe the FCA should encourage public debate on measurement, including on the extent to which actions taken by the regulator can affect outcomes and achieve change.

The metrics that are used to judge success within the organisation should also be used internally, to align incentives.

We appreciate that much of the work that the FCA does is commercially confidential, and that it is hard to judge the impact of interventions that aim to prevent a company from operating in a certain way. However, we see no reason why aggregated data measuring preventative activity cannot be published.

In addition we would urge the FCA to engage fully and publicly with the National Audit Office (NAO) work on performance measurement by regulators, and seek to be a leader amongst regulators in developing the necessary methodologies.

Q6: Do you think our intervention framework is the correct one?

The framework as set out in Fig 1 on page 20 implies an 'after the event' approach, when the harm has already been done. We believe the FCA should adopt a more preventative approach. The FCA could improve its intelligence, by analysing the information it gets from *all* sources in 'real time' so that it can spot emerging issues and trends. It should ensure the relevant parts of the organisation act promptly on this intelligence. House Views provide a useful market overview but are not designed to pick up 'here and now' issues. The FCA should also have regard to information provided by the Money Advice Service and Financial Ombudsman (FSMA Section 1 (2)(c) and (d)). We question the extent to which this happens in practice. The way the FCA uses consumer intelligence, whether from individuals or through consumer groups, could also be improved.

The section on diagnostic tools does not mention business model analysis. Knowing how firms plan to make their money helps identify potential detriment. Profitability levels and how money flows through the business provide useful indicators to assess the fairness of products and services. Business model analysis would help the FCA focus on preventing poor conduct and mis-selling in the first place. This will be all the more important as firms change their business models in response to both Brexit and ring-fencing.

On the 'type of harm' table on page 19, we would argue that the consumer protection objective is also relevant to 'Prices too high or quality too low', as illustrated, for example, by the FCA's action on HCSTC. Competition does not work in many financial

services markets, or takes too long. We believe the FCA should consider speed when it decides which tool to use. Lengthy market studies that identify problems in the market, whether competition issues or conduct risks, are often followed by consultations, trials or discussion papers. The amount of time taken to address consumer detriment can be long and unnecessary. We have also seen thematic reviews that find the same problems, even on a second or third review, which the FCA attempts to fix by issuing more guidance. For example, the FCA published further guidance on structured products, having discovered that more work with firms was required, although it had put out guidance in 2012. Wealth management is another example of where consumer detriment has been allowed to persist while more help and guidance is offered to miscreant firms.

It is also vital that the FCA is more open and transparent, in line with principles 7 and 8 of good regulation. This would ensure firms are clear about the standards expected and consumers are clear that the regulator is taking action to protect their interests. We believe, for example, that the FCA should publish details of consultation respondents and also of senior executives' meetings with firms, trade associations and other stakeholders.

Section 348 of FSMA appears to be at odds with the regulatory principles. This damages transparency and accountability. However, we know that the FCA can find a way around Section 348 when it chooses to. For example, by writing rules forcing firms to publish their complaints data, the FCA was able to publish its own, firm specific, complaints data. It has also been able to publish the names of six firms referred for further investigation by the enforcement division following the publication of the thematic review of the fair treatment of long-standing customers in life insurance.

The National Audit Office has noted that, due to Section 348, it "could not carry out a full assessment of the effectiveness of the FCA's actions".[1] We note also that the Complaints Commissioner has concluded that there is "a risk that the FCA's reliance on Section 348 will be seen as seeking to protect itself from proper scrutiny of its regulatory decision-making".[2] There is more the FCA could do to make full use of its powers within the existing framework. For example, it has failed to use a new power given to it by the Financial Services Act 2012 to publicise when it takes action to require a firm to remove or amend a financial promotion. Instead, anyone reporting a misleading promotion to the FCA is told that "for legal reasons we cannot tell you what action we have taken as a result".

Leaving the EU will offer the opportunity to remove or amend Section 348 of FSMA and we believe the FCA should publish a discussion paper reviewing its current transparency framework and how it has been applied in practice. This could also identify how reforms to Section 348 could enhance the ability of the FCA to use regulatory transparency to fulfil its objectives.

Q7: Do you think the way we interpret our objective to protect and enhance the integrity of the UK financial system is appropriate? Are there other aspects you think we should include?

Yes.

Q8: Where do you believe the boundary between broader policy and the FCA's regulatory responsibility lies?

At a high level, the FCA is a "taker" of public policy decisions; its role is to fulfil its statutory objectives within the context of decisions that have already been taken by government and parliament.

There can be unintended consequences when the FCA neglects policy issues. For example, when government decided there should be a price cap on high-cost short-term credit (HCSTC) the FCA implemented the proposals in the narrow way parliament

[1] https://www.nao.org.uk/wp-content/uploads/2016/02/Financial-services-mis-selling-regulation-and-redress.a.pdf

[2] http://fscc.gov.uk/wp-content/uploads/FCA00084-Nettleship-Adam-Stage-2-Final-Decision-24-11-16.pdf

intended. Other forms of credit, such as credit cards and overdrafts, often cost more than the HCSTC cap, and cause a much higher quantum of detriment. It has also led to the evolution of products designed to circumvent the rules, such as new forms of revolving credit, which can be as detrimental to consumers as payday loans but escape the price cap and other consumer protections of HCSTC.

If it was considered that the interest costs of payday loans were too high, doesn't the same logic also apply to credit cards, where people pay a high amount of interest over time? In this example, we think affordability should always be taken into account when credit is sold, but the general point is that there should be a more active discussion about wider policy issues that arise from regulatory decisions, so that the actions of the FCA are more consistent and effective.

The FCA also needs to take account of the external environment. A small interest rate rise would have a severe impact on families who are already only just managing. Given the potential impact of Brexit on the economy and firms' business models, the FCA should consider the extent of its role in ensuring consumers are not disproportionately affected. For example, if there is a squeeze on lenders' business models, they may lend less responsibly and collect more aggressively.

We would encourage the FCA to highlight the areas where it feels it is operating on the boundary in order to clarify who is best placed to take action in the interests of consumers. For example, someone needs to take action on the demutualisation of risk arising from Big Data, and on data ownership in open banking. The FCA cannot act alone on either of these issues, but it can, and should, lead the debate. Brexit is a huge distraction to policymakers: the FCA will need to be insistent, and to propose policy solutions.

Q9: Is our understanding of the benefits and risk of price discrimination and cross subsidy correct? Is our approach to intervention the right one?

We agree that in financial services markets there can be features which lead to price discrimination and cross-subsidy. In addition to the features identified it can also occur due to:

- **Incomplete contracts**: This is an agreement that does not specify actions and payments for all possible contingencies. For example, a mortgage contract may specify the interest rate that will be charged for the first two years but then the consumer is placed onto a 'variable' rate with no controls over the subsequent rate that can be charged. Another example is a protection insurance contract that allows the firm to vary the monthly premium in the future. In these circumstances consumers are not able to take these factors into account when choosing products.
- **Contingent charges/discontinuous pricing**: Contingent charges apply only in certain circumstances, for example, if a consumer exceeds an overdraft limit. Discontinuous pricing is where small changes in behaviour can have a significant impact on the price charged. For example, unauthorised overdraft charges often punish consumers for small mistakes and those in financial difficulty with charges significantly in excess of marginal cost. In most circumstances it will be impossible for consumers to take these contingent charges into account when choosing products. Cross subsidies will continue to occur even if these charges are clearly disclosed. For example, even if the default charges for a loan are disclosed consumers won't take them into account as it is impossible for them to know or predict whether or not they will default. In a perfectly competitive market cross-subsidy may occur as fees from defaulters are used to subsidise the loans to non-defaulters. In many other markets (including some financial services markets) contingent charges are restricted to the net additional administrative costs incurred.[3]

[3] https://www.fs-cp.org.uk/sites/default/files/cma_retail_banking_market_investigation_20160129.pdf

However, it is also important to note that what the FCA calls cross-subsidies do not always result in transfers between different groups of consumers. They may result in transfers between consumers and firms and therefore higher profits for firms.[4] For example if the market for loans is not perfectly competitive, higher default charges will enable firms to increase their profits at the expense of defaulting consumers. In the case of the mortgage customers of what was formerly Northern Rock, the fact that some are now paying a higher SVR than others results in additional profit for the private equity owners of those loans, rather than transfers to other groups of consumers.[5] In other circumstances there may be transfers between consumers and intermediaries – particularly where intermediaries are remunerated by commission. The FCA should not take at face value any claims by firms that tackling what it refers to as cross-subsidies or excessive contingent charges will always result in other groups of consumers losing out through higher charges (sometimes referred to as a 'waterbed' effect).

We also note that there are positive cross-subsidies, such as risk-pooling for insurance products. This is legitimate, and should lead to more affordable insurance for consumers. However, there is a danger that increased use of Big Data to inform risk and pricing strategies may increase access for some groups of consumers while restricting it for others. Use of such data offers firms opportunities for increasingly individualised risk assessments, which would have a significant impact on risk pooling and individual premiums.

This demutualisation of risk is a policy issue. The government recognised this in setting up Flood Re and there may be other products, over time, where a degree of mutualisation may be socially desirable in order to enable affordable access to essential financial services.

Understanding cross subsidies requires regulators to undertake analysis of the costs of serving different groups of consumers and the costs incurred by firms under various sets of circumstances. The regulator will have to 'follow the money' and understand how firms' business models impact on their pricing strategies. We were extremely disappointed that the CMA did not seek to analyse properly or tackle the "free if in credit" model in retail banking. It is impossible to gauge whether the current account market is competitive without knowing the cost and profitability of bank accounts and related products and services. In the current account market, cross-subsidisation, coupled with murky pricing structures and contingent charges, obscures the true cost. We urge the FCA to look closely at the FIIC model and the distortion it can create in the market. The FCA should not repeat the mistakes of the CMA in expecting transparency remedies to make a significant difference to the level of unauthorised overdraft charges.

In addition to conducting this analysis we support the FCA's proposal that it should be transparent about the judgements it makes about the "acceptable" level of price discrimination and cross subsidy between different groups of consumers or different products and services. We note that the Mission document states that the FCA's statutory objectives can make a clear case for interventions in some markets, such as where it can "justify them as increasing competition". We would also note that there are often strong consumer protection arguments for the regulator to take action on cross subsidies. For example, allowing excessive default charges or unauthorised overdraft charges harms consumers in financial difficulty, could lead to irresponsible lending and does not incentivise firms to provide early help to consumers at risk of default. If firms are making significant profits from selling certain types of add-on products (such as PPI) then it can lead to weak conduct standards and pressure on staff to sell these products in order to make higher levels of profit.

[4] It should also be noted that cross-subsidies could also be absorbed by firms through their inefficiency or through higher operating costs rather than in higher levels of profit
[5] MoneyMarketing, 24th August 2016, "Thousands of Northern Rock Borrowers Miss Out on Rate Cut" https://www.moneymarketing.co.uk/thousands-northern-rock-borrowers-miss-rate-cut/

Q10: Does increased individual responsibility increase the need and scope for a greater and more innovative regulatory response?

We do not believe that consumers can be expected to take individual responsibility for their decisions, until firms treat them fairly, by avoiding conflicts of interest and acting in the best interests of their customers. The factors the FCA identifies as increasing individual responsibility, together with the apparent failure of the TCF principle, lead us to conclude that a legal duty of care is the best way to protect consumers' interests, at the same time empowering them to make choices.

Q11: Would a Duty of Care help ensure that financial markets function well?

The Panel's primary motivation for proposing a duty of care[6] is not the fact that it would give consumers a legal right to take a dispute with a financial services provider to court. We believe that the principal value of a duty of care would be preventative, by requiring firms to avoid conflicts of interest, and to ensure their customers do not suffer unreasonable harm or loss. It is our intention that, where disputes do occur, they should be handled by the Financial Ombudsman as now. Recourse to the courts would be a last resort, but the existence of this consumer right should act as a further deterrent.

Conflicts of interest have given rise to the vast majority of product mis-selling and other conduct failures in recent years and the TCF principle has clearly not worked to prevent these, to the detriment of consumers and firms themselves.

Over time we believe that a duty of care would engender long term cultural change in firms, and help them to demonstrate trustworthiness. It would rebalance the bargaining position and information asymmetries between firms and consumers. Properly applied, it might eventually allow for a reduction in the amount of detailed rules.

In conjunction with the recently-introduced Senior Managers and Certification Regime, we believe that a duty of care would help to define the respective responsibilities of product providers, advisers and other intermediaries and consumers. In this way a duty of care would reduce the need for "cure" in the form of redress schemes and other retrospective action by the FCA, thus providing greater certainty for firms and consumers alike.

There are numerous examples of judicially-recognised duties of care (including solicitor-client, employer-employee, doctor-patient and manufacturer-consumer) and in the Panel's view it is anomalous that one does not apply to the relationship between a financial services firm and its customers.

The preventative nature of a duty of care, and the clarity it would bring, would ensure that financial markets work better than at present. It would be a very clear demonstration of the FCA's operational objective to protect consumers.

From our wide engagement with a range of stakeholders in recent months, we believe that support for a legal duty of care is growing. We urge the FCA to test its argument that a duty of care is unnecessary by consulting on the proposition.

Q12: Is our approach to offering consumers greater protection for more complex products the right one?

In general, yes. The recent mis-selling of complex interest rate hedging products is a good example of where greater protection should have been available to protect bank customers.

Financial services products are growing in complexity, and financial decisions can have far-reaching consequences. There is generally too much choice, rather than too little, and even the more general products can be confusing for consumers. We are disappointed, therefore, that the ABI has decided to discontinue its work on simple products. We believe that simple financial products would help cut through the confusion

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[6] https://www.fs-cp.org.uk/sites/default/files/duty_of_care_briefing_-_jan_2017.pdf

consumers currently feel, and go some way to addressing some of the complexities, such as lengthy terms and conditions and hidden fees and charges.

However, it is not always the product that is the problem, but the way it is sold. PPI was a straightforward product, but banks sold it to people who did not need it, or could never claim on it. This is why removing conflicts of interest, and a close scrutiny of firms' business models, are so important.

Q13: Is our regulatory distinction between consumers with greater and lesser capability appropriate?

FSMA requires the FCA to 'have regard to the differing degrees of experience and expertise that different consumers may have'. However an individual consumer can also have differing degrees of experience and expertise.

Capability isn't static. It fluctuates over time, and in response to changes in circumstances or stressful situations. In the same way that a patient's blood pressure may rise at the sight of a doctor with a stethoscope an otherwise capable person's capability may fall at the sight of figures or forms. It isn't possible to predict with any accuracy how capable an individual will be in a particular situation. Someone who, on the face of it, seems perfectly capable because they've bought a house, has investments and runs a business may be significantly less capable when assessing pension options.

Moreover, even highly capable consumers are prey to firms' exploitation of behavioural biases. The most likely victims of investment scams are wealthy, educated, middle aged men. Rather than attempt a categorisation of greater or lesser capability, the FCA should ensure firms are responsible for making sure the products and services they sell to every customer are suitable for that customer as far into the future as is possible.

Q14: Is our approach to redress schemes for issues outside our regulatory perimeter the right one? Would more specific criteria help firms and consumers?

Voluntary redress schemes for issues outside the regulatory perimeter are not guaranteed to work for the people who have suffered harm if those schemes are agreed through private negotiations with the wrong-doer. The perception will always be that a deal has been done behind closed doors and therefore the financial organisation has 'got away with it'. Communication about voluntary schemes needs to be clear and firms should be made to contact and repay all affected customers rather than the onus being placed on the customer.

As customers are usually not in a position to take court action and the FCA cannot force a redress scheme, we suggest that the regulator looks at the option of a financial services tribunal scheme. Those who support the introduction of financial services tribunals believe that a gap exists below the level of the High Court's specialist Financial List and above the level of Section 404 schemes and the Financial Ombudsman Service. The FCA has tried to fill this gap with its ad hoc redress schemes, overseen by Section 166 skilled persons, for both interest rate hedging products mis-selling and RBS Global Restructuring Group complaints. However neither of these 'mass dispute resolution schemes' really delivers what consumers want - clear independence and a 'day in court'.

The gap would be better filled by an option which:

- Inspires public confidence;
- Is simple to access;
- Is relatively inexpensive;
- Gives bank customers real rights;
- Establishes a publicly accessible body of legal authority on how the FCA's Handbook rights and duties are to be applied in practice; and
- Is capable of making a positive contribution to changing bank culture.

We believe that Financial Services Tribunals modelled on Employment Tribunals would enjoy all of these benefits.[7] At the very least, the FCA could consider whether there might be a role for an independent 'consumer advocate' in the design of voluntary schemes. This would be something like the role of the policyholder advocate in the redistribution of insurers' inherited estates.

Q15: What more can we do to ensure consumers using redress schemes feel they are receiving the appropriate level of personal attention?

The FCA's redress policy should change to involve more proactive redress schemes, greater use of Section 404 powers, meaningful consultation with victims/consumer groups and the introduction of financial services tribunals.

If customers have to apply for redress many will miss out on what is rightly theirs due to lack of awareness, lack of confidence, and/or lack of know-how. Even those who do claim may end up with the wrong amount for all the same reasons. Claims Management Companies (CMCs) will always move into those gaps; they're aware, have the know-how and can calculate quantum. People then lose out on the percentage charged by the CMC, but at least they have got something back. Redress schemes should be set up in such a way that people entitled to compensation will get it without having to make the effort and without needing the services of CMCs. The reputation of financial firms will be enhanced by holding up their hands, saying "we got it wrong, and here's your money back". That approach will save firms money as well as reputation.

As we note above, the unpopularity and ineffectiveness of some redress schemes has been because they were imposed on victims without proper consultation, either with consumer groups or with the victims of misconduct. Until the FCA's approach changes and there is meaningful consultation about redress schemes it is likely that the complaints will continue. Finally, it would be helpful if the FCA were to commission independent evaluations of its redress schemes.

The Panel would support greater use of Section 404 schemes and, as we say above, the proposals being discussed for a financial services tribunal scheme. The introduction of financial services tribunals together with a statutory duty of care would be capable of bringing about a sea change in firms culture and behaviour to the advantage of their customers.

Q16: Is our approach to giving vulnerable consumers greater levels of protection the right one?

People who are vulnerable do need greater levels of protection against possible harm, but they also need protection against being excluded from products and services.

There is too much emphasis on labelling people as vulnerable. Vulnerability isn't just about low income, chronic illness, disability, or aging. It's not a steady state; it fluctuates given changes in personal circumstances. As the FCA acknowledges, we are all vulnerable at some points in our lives. Nor is low income necessarily an overarching factor. Disability or chronic illness does not necessarily equal low income (though it is true it often does). People can also have a high income and still be crippled by debt, or vulnerable to scams and fraud. Those with significant assets can also be vulnerable, especially if those assets are acquired suddenly: a pension pot, an inheritance, or a lottery win, for example. People who need to release cash from their homes are equally vulnerable to poor treatment by firms.

Changes in the market can also cause vulnerability. Greater use of technology, for example, can make some people who were previously coping, vulnerable and unable to operate effectively. The faster the pace of change the more difficult people find it to keep up.

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[7] Capital Markets Law Journal - Tools for changing bank culture: FCA are you listening http://cmlj.oxfordjournals.org/content/early/2016/02/09/cmlj.kmw001

It is not surprising that people on low incomes tend not to have the 'bandwidth' to plan for the long term. But it is not clear what point the FCA is making here. People on low incomes are generally highly capable at managing the little they have, but loss of even a small amount of money can have a very high impact. The FCA's intervention on HCSTC is a step in the right direction, but a tiny one. Similar credit products such as logbook loans, guarantor loans, benefit loans and rent to own, all remain unregulated to the extent of payday loans. People on low incomes are more likely to slip into overdraft and be heavily penalised for it. We also note that the FCA devotes considerable resources to raising awareness of scams and fraud, but little to illegal money lending, which can have a very serious impact on those affected.

Some firms have made good efforts to deal with some aspects of vulnerability, including physical adjustments such as talking ATMs and specialist bereavement services. But vulnerability is such a vast and constantly changing issue that trying to identify those people who are vulnerable takes more training and understanding than is likely to be profitable for financial services firms.

The Mission also says that 'some consumers…find it particularly difficult to take responsibility for decisions about financial services'. What it should say is that some consumers find it particularly difficult to understand the information firms give them. The logic of our proposal for a duty of care is that firms would need to ensure all consumers understood what product or service they were buying, and to take account of differing degrees of vulnerability.

In order to measure whether concerns about vulnerability are actually being addressed, the FCA may want to consider whether it would be appropriate to include a specific section in the annual report on how consumer vulnerability has been taken into account. This should include an evaluation of interventions such as ScamSmart.

Q17: Is our approach to the effectiveness of disclosure based on the right assumption?

We agree that disclosure and transparency can sometimes have a limited effect in correcting market failures. Overloading consumers with information can lead to poor decisions and inertia. In Amelia Fletcher's recent report into the role of demand-side remedies in driving effective competition,[8] she concludes that "while disclosure remedies can have valuable positive impacts on consumer decision-making, there is also evidence of their being ineffective or even harmful."

The Panel is currently researching why some consumers do not switch financial services products, even when prompted to do so. Our findings are consistent with those in other studies, that consumers can quickly become disengaged with too much information.

The FCA's 'Smarter Communication' initiative is identifying all the right issues, but it will be hard to make progress on intractable issues like lengthy and incomprehensible terms and conditions unless the FCA is prepared to take firm action.

Q18: Given the evidence, is it appropriate for us to take a more 'interventionist' approach where conventional disclosure steps prove ineffective?

Yes. We believe there has been an over-reliance on disclosure to change consumer behaviour and a reluctance to use supply-side remedies. Disclosure remedies place too much expectation on the consumer and are not enough. Where disclosure is unlikely to be effective, the FCA should be more proactive in intervening with product rules to protect consumers. Amelia Fletcher says in her report[9] that, "by placing boundaries around what suppliers are, and are not, allowed to do, outcome control remedies can play an important role in ensuring that competition drives positive consumer outcomes". The report also includes a recommendation for more evaluation of remedies. Where the FCA evaluates its disclosure remedies and finds they have not improved consumer

[8] The Role of Demand-Side Remedies in Driving Effective Competition, Centre for Competition Policy
[9] The Role of Demand-Side Remedies in Driving Effective Competition, Centre for Competition Policy

outcomes, it should be prepared to make rules ensuring firms are treating their customers fairly.

We do not see a more interventionist approach as an alternative to disclosure. Firms should be required to disclose information anyway. Even if consumers do not act on it directly, having the information in the public domain acts as a market discipline as other providers, and commentators, can see it too. This is the logic of the FCA's publication of its general insurance value measures, which we welcome.

Q19: Do you think our approach to deciding when to intervene will help make FCA decisions more predictable?

Yes, this should provide more clarity for firms. However, it is important that the FCA continues to be flexible and responsive to emerging problems and consumer concerns, particularly when significant consumer detriment could result from poor firm conduct. Publishing what the FCA 'decides not to do' is problematic given the potential for poor conduct in those areas out of the spotlight.

Q20: Are there any other factors we ought to consider when deciding whether to intervene?

The FCA should engage in more proactive intervention. It is more efficient and cost effective to prevent detriment from happening in the first place rather than clearing up after the event. The Panel is concerned, for example, that following market or competition studies it is a long time before recommendations are implemented and conduct issues addressed. This allows consumer detriment to continue long after it has been identified.

Q21: What more do you think we could do to improve our communication about our interventions?

The FCA should utilise its new power to publicise occasions where it has forced a firm to amend or withdraw a misleading financial promotion. At the moment the FCA keeps its actions secret, which means that firms are not provided with clarity about the required standards. Publishing the details of the FCA's interventions would mean that firms are clearer about the standards expected and would make the FCA's decisions more predictable. This would be particularly helpful to smaller firms, who can struggle to access such knowledge. As we have said previously, we do appreciate that much of the work the FCA does is commercially confidential. However, we see no reason why, at the very least, aggregated data cannot be published without identifying particular firms.

Q22: Is there anything else in addition to the points set out above that it would be helpful for us to communicate when consulting on new proposals?

The FCA should be clearer about what it is investigating, including where possible the names of the firms. We welcome the fact that the FCA chose to name the firms referred to enforcement after the review of fair treatment of long-standing customers in the life insurance sector.

When consulting on new proposals it would also be helpful for the FCA to communicate:

- **Data:** Data gathered should be published wherever possible.
- **Redress schemes**: The FCA should publish the names of the firms which are subject to the scheme, list what activity the firms are undertaking, the text of all letters used in customer contact exercises, the criteria the firms are using to calculate redress, the rules of the redress scheme and the scope of any appeals mechanism.
- **Evaluation**: The FCA should set out how and when the proposals will be evaluated following implementation.
- **Cost-benefit assessments**: Proposals should be accompanied by a cost-benefit analysis which should cover a short-list of potential options rather than just the

one which the FCA has decided to implement. These should make proper allowances for consumers' time and costs imposed on them. For example, if the FCA decides to go ahead with a complaints-led approach (instead of a redress scheme) for PPI complaints under the Plevin ruling, the FCA will be placing absolutely no value on consumers' time in making those complaints.

- **Guidance for supervisors**: When the FCA scrapped its review of bank culture and instead rolled the process into normal supervision it would have been helpful to publish the framework which supervisors would be using to assess culture.

Q23: Do you think it is our role to encourage innovation?

The Financial Services Act 2012b removed the requirement for the FCA to have regard to the need to "facilitate innovation". The Government said at the time that it did: "not consider it appropriate for either regulator to have to have regard to the desirability of facilitating innovation. As the events of the last few years have shown, a more nuanced approach to innovation in financial services is required, including a regulatory environment in which innovation can deliver desirable outcomes for users of financial services, instead of promoting or discouraging innovation per se".

We agree with this view to an extent. However, it is also the role of the regulator to promote competition and ensure there are no barriers to entry. Where innovation has the potential to address these objectives, it should be encouraged, as Project Innovate's Regulatory Sandbox is intended to do.

Q24: Do you think our approach to firm failure is appropriate?

Yes.

Q25: Do you think more formal discussions with firms about lessons learned will help improve regulatory outcomes?

Probably, but this needs to be evaluated.

Q26: Do you think that private warnings are consistent with our desire to be more transparent?

We question the effectiveness of warning notices, which we believe should contain more information and not be anonymised. Warning notices could be aligned more with criminal cases, where the accused is named before being found guilty or not guilty. Increased transparency can give firms a clearer incentive to improve behaviour or treat customers fairly. The Panel would support any efforts the FCA makes to put more information in the public domain.

It is important that the level of financial penalties levied by the FCA both on firms and individuals provides a credible deterrent against misconduct. The Parliamentary Commission on Banking Standards was clear that the FCA needs to review its penalty setting framework to allow for a "further substantial increase in fines". The Panel supports the FCA's penalty review being undertaken as soon as possible to allow this to happen. Finally, to ensure the Senior Managers Regime offers a strong incentive to improve standards the FCA should always consider enforcement action against the individual responsible when it takes enforcement action against a firm. If it decides not to proceed with enforcement action against the individual then it should state clearly why it considers that holding the individual to account is not in the interests of consumers. There are already a number of areas where individual responsibility is clearly allocated. For example, firms have been required to allocate a named individual to oversee their compliance with fair complaint handling since 2011. Despite these rules the FCA has failed to take action against individual executives who oversaw failings relating to PPI complaint handling.

Annex

There are numerous cases where TCF is failing customers, but where firms have not been breaking FCA rules, for example:

- In the savings market, banks can reduce interest rates on existing customers' accounts by declaring an account "obsolete". TCF only requires banks to tell customers about changes to the interest rates on their account range. Equally, new rules on disclosure of interest rates are not being applied to "obsolete" accounts (which are of course not obsolete from the customer's perspective). Under a duty of care, banks should ensure that customers of "obsolete" accounts were migrated to accounts offering at least as good value, without the requirement to open a new account.
- Banks continue to promote and reward staff on the basis of sales made to customers. PPI is the most egregious example of this; TCF makes no difference.
- If a customer tries to withdraw funds beyond their overdraft limit, banks can allow the withdrawal without telling the customer at the point of making the decision what charges will result. Under TCF, as long as the customer has been told the charging structure, this is considered fair.
- The recent FCA thematic review into early arrears management in unsecured lending shows that firms are still missing early opportunities to identify customers in financial difficulty and offer appropriate forbearance. Moreover, the findings showed that a firm's culture influences the approach taken to giving due consideration and forbearance to customers in arrears difficulties.
- Credit card companies frequently offer inappropriate products with unaffordable credit limits to consumers, and fees are not always transparent and proportionate. TCF has no impact on this behaviour.
- If suspicious activity, or other reasons of de-risking, means a bank chooses to close a consumer's account, they are very slow to clear the customer and allow them access to their funds, or take further action. Customers are meanwhile in limbo, and cannot utilise their account, or access their money.
- Consumers are left languishing in old Basic Bank Accounts, often on less favourable terms and potentially facing fees or charges on their account. TCF does not ensure banks move their customers onto the new non-fee charging Basic Bank Accounts.
- Pension companies offer their loyal customers annuity rates which can be between 15%-20% below the market best rates. They also fail to offer enhanced annuities to their customers meaning that people with health conditions can miss out on higher rates. Offering a consumer a rate 20% below the best market rate is equivalent to taking the last 11 years of their pension contributions away.
- Insurance companies operating with-profits funds are able to use the money held in these funds for purposes which benefit shareholders such as paying mis-selling costs, funding a deficit in the insurance company's staff pension scheme, subsidising new business and paying shareholders' tax bills on their share of profits from the fund.
- Customers who have been with their home insurance provider for 5 years pay 70% higher premiums than new customers despite evidence suggesting that they pose no higher risk than new customers.[10]

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[10] FCA (2015), Occasional Paper 12, Encouraging consumers to act at renewal Evidence from field trials in the home and motor insurance markets