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

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Enforcement and Markets Oversight Division
Financial Conduct Authority
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Dear Sir / Madam

FCA Mission: Approach to Enforcement

The Financial Services Consumer Panel welcomes the opportunity to respond to the FCA's Approach to Enforcement. It is disappointing that it only asks whether the approach has been set out clearly, suggesting the FCA is not open to suggestions for improvements in its approach, i.e. this is not really a consultation at all.

Enforcement must change the behaviour of firms to be an effective deterrent. Higher financial penalties for firms need to be accompanied by stronger action against individuals and the FCA making full use of its existing powers. For enforcement to be effective, it should also lead to loss of reputation, customers 'voting with their feet' and a reduction in shareholder value. Deterrence could be increased if the FCA made it easier for consumers to switch away from firms that had behaved badly. There is currently very little evidence about how consumers use knowledge about enforcement action to make informed decisions about choosing or switching providers; the FCA could explore this further.[1]

The FCA needs to be bolder in its approach, using the full extent of its powers to build consumer confidence in the regulator and reduce consumer harm. It would be helpful for the FCA to identify the reasons for its current approach and commission an independent review of where it might go even further. As in our response to the FCA Mission, we have long called for greater use of proactive redress, and it is not clear why the FCA doesn't make more use of this tool. Until the FCA's approach changes and there is meaningful consultation about redress schemes it is likely that complaints will continue in this area.

On evaluating the effectiveness of enforcement action and whether public value has been added, the Approach document is silent on the fair treatment of the victims of misconduct, or the whistleblowers who put their careers on the line to bring misconduct to light. There is more focus on gaining feedback from the firms and individuals "subject to investigation", rather than from victims and whistleblowers.

There should be greater clarity about the role of the Regulatory Decisions Committee (RDC) and the number of cases it rejects or orders a lower or higher financial penalty. It should be clear that the RDC could order an increased financial penalty, and the RDC should set out publicly the criteria it uses change in the level of financial penalty. The RDC should also be clearer about how it exercises its power in relation to prohibitions, suspensions/restrictions and when it overrules a decision by the FCA to refuse an authorisation. A greater number of consumer and SME representatives should serve on the RDC, and current representatives of industry groups or trade associations should not be permitted to serve due to the potential for conflicts of interest.

[1] *Ipsos Morri on behalf of the Financial Services Consumer Panel -Face to Face Omnibus Survey (June 2014).* 41% of respondents in a FSCP survey said fines for financial misconduct would influence their decision 'a great deal' when choosing a financial services provider, the second highest reason for choosing a provider.

We welcome the collaborative working with law enforcement agencies and international regulators but it would be useful to get clarity on exactly how the FCA works with investigatory agencies such as the Serious Fraud Office and City of London Police in deciding which cases to take forward.

A bolder approach

The FCA should make use of its powers that enable it to name firms where it has made them amend or withdraw misleading financial promotions. Publishing the details of the FCA's interventions would lead to greater clarity for firms of expected standards and would make the FCA's decisions more predictable. This would be particularly helpful to smaller firms. We do appreciate that much of the work the FCA does is commercially confidential. But Parliament gave the FCA a specific power to name firms when it issues them with a direction to withdraw or amend a misleading financial promotion. The FCA has failed to use this power in the six years since it was granted. However, even if the FCA continues its policy of failing to use the financial promotion powers it was given by Parliament we see no reason why, at the very least, aggregated data cannot be published without identifying particular firms.

There are already many 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 this rule, the FCA has failed to take action against individual executives who oversaw failings in PPI complaint handling.

The penalty discount should be withheld until the firm involved has satisfactorily demonstrated that it has provided effective redress to consumers and identified the individuals responsible for the misconduct. There should also be stronger action against firms or individuals which mislead the regulator or attempt to cover-up misconduct.

Transparency

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 do this it should state clearly why it considers that holding the individual to account is not in the public interest.

The FCA should name the firms involved in investigations as it did following the thematic review into the treatment of long-standing customers. It should provide regular updates as to the status of the investigations. If it feels unable to name the individual firms involved then it should name the product and practice being investigated and the number of firms currently under investigation.

We question the effectiveness of warning notices, which we believe should contain more information and not be anonymised. We note that when this power was being debated a previous head of enforcement at the FSA described it as a "a rather small move" on the "transparency dial."[2] The Government was clear that it believed "that greater regulatory transparency and disclosure will be an important tool for the FCA to promote better outcomes for consumers, engender better practice across industry, and provide firms with greater clarity over regulatory expectations and what the regulator considers unacceptable behaviour." The Government was also clear that "the new power in relation to warning notices is an essential pillar of this new approach."

[2]Treasury Committee, Financial Conduct Authority, Twenty Sixth Report of Session 2010-2012, Q136

It is important to note that a warning notice is only issued following a full investigation by its Enforcement Division, an intensive process which can often take many months to complete. While the investigation is ongoing, and therefore prior to the warning notice being issued, the subject will have many opportunities to set out their position, including at scoping meetings, settlement meetings and interviews. Further, it is the usual practice to send the subject a preliminary investigation report (PIR) which sets out the facts which the investigators consider relevant to the matters under investigation. The PIR contains sufficient detail to enable the subject to review the findings of fact in their context and to confirm whether the facts are complete and accurate. It also sets out the Enforcement Division's provisional views on possible breaches. The subject is invited to comment that those facts are complete and accurate, or to provide further comment. The Enforcement Division will then take into account any response received before deciding whether to issue a warning notice. Increased transparency on warning notices could give firms a clearer incentive to improve behaviour. The Panel would support any efforts the FCA makes to put more information in the public domain.

It is unclear what thresholds are used to allow banks to undertake and commission their own internal investigations or, to set the rules of their own redress scheme (sometimes using appointed lawyers) and what requirements it imposes on the conduct of these investigations and the publication of results. Relying on the results of a bank's own investigation risks damaging confidence in the enforcement process.

Sanctions

It is important that the level of financial penalties levied by the FCA both on firms and individuals provides a credible deterrent against misconduct. We support the recommendation of the Parliamentary Commission on Banking Standards that the FCA reform its policy to allow for a further substantial increase in fines. Financial penalties need to be higher to provide a stronger incentive for shareholders to be more proactive to prevent misconduct.

Particularly for the large banking groups the financial penalties imposed for misconduct only represent a small proportion of their annual profits. As part of the penalty review the FCA should conduct and publish an evaluation of the level of its penalties as a proportion of firms' profits and compare this with the approach of US regulators and regulators in other jurisdictions. There needs to be greater detail about how the FCA calculates relevant revenue and should consult on this as part of the penalty review. For some misconduct, the firm will carry on receiving ongoing revenue from renewal of the contracts (e.g. from ID theft insurance and card protection), and this should be considered in the calculation. There should also be a higher percentage of relevant revenue as the starting point for misconduct at each of the levels set by the FCA.

The approach should make it clear that where a consumer contact exercise is carried out this does not represent full disgorgement due to the low predicted response rates. For example, if a firm is given full credit for disgorgement when it has conducted an exercise where only say 30% of consumers have responded then it is likely to continue to benefit financially from the misconduct – particularly where the profit on the product is very high.[3] More factors should be taken into account.

The FCA should ensure that wherever possible the enforcement financial penalty and redress costs are paid through a significant reduction in bonus pools. Levels of bonus

[3] We note that only 33.9% of consumers responded to letters claiming redress for mis-sold ID theft and Card Protection Insurance by CPP in association with the major banks. Banks received commissions of between 40% and 60% of the premium for selling these products.

clawback and malus for executives presiding over misconduct seem to be low or non-existent.

The Panel opposed the new option of partially contested cases. This will have the result of more firms contesting the size of a penalty and result in increased costs for the FCA.

Effective redress

Early settlement helps consumers get redress more quickly. The cost of this is a lack of transparency meaning that the public never know about the wrongdoing so consumers cannot then make informed decisions about any given firm. The deterrent effect is then lost.

An effective redress system should improve the incentive for firms to treat customers fairly. We continue to see problems with the complaints processes operated by financial services companies. Uphold rates at the Financial Ombudsman remain too high – with seemingly little financial penalty imposed on the firms involved. The FCA should make greater use of its s404 redress powers to order past business reviews. It should also ensure that wherever possible redress is proactive rather than requiring consumers to respond to a communications exercise. The method that the FCA has required firms to use to calculate redress should be transparent.

Whistleblowers

FCA should learn more from the experience of whistleblowers and others who report misconduct to the regulator. Currently, it is not gathering systematic feedback about their satisfaction with their relationship with the regulator. It should also introduce a system of financial rewards for whistleblowers by requiring firms as part of the enforcement settlement with the regulator for the firm to make additional payments to the whistleblower on top of any financial penalty. We are not suggesting these should be on the scale of the financial rewards available in the US, but would be designed to replace the lost income suffered by the whistleblower as a result of reporting the misconduct.

The FCA needs to provide greater feedback to those reporting misconduct to the FCA, listing where action was taken as a result of their information, which will build trust in the process and ultimately the FCA.

Yours faithfully

Sue Lewis

Chair, Financial Services Consumer Panel