

**REFORMING FINANCIAL MARKETS**

**A RESPONSE TO THE TREASURY WHITE PAPER**

**FROM THE FINANCIAL SERVICES CONSUMER PANEL**

**SEPTEMBER 2009**

## CONTENTS

Introduction.....	3
Overview.....	6
<b>Consultation Questions</b>	
Reforming regulatory institutions.....	14
Competitive Markets that work for consumers.....	23
Barriers to Entry and Simple Products.....	31
Compensation.....	39
Strengthening mutuals.....	40

## Introduction

1. The Financial Services Consumer Panel appreciates the opportunity to comment on the White Paper. We have witnessed an unprecedented financial crisis which, although not caused by consumers, has had a hugely negative effect on them. It is essential that lessons are learned to ensure that the future regulatory regime is able to deliver financial stability and effective supervision.
2. We have responded to the detailed questions in the White Paper, however given that the legislation underpinning the regulatory system is to be revisited, we would like to offer some broader observations in order that the regulatory regime is strengthened adequately and consumer focused regulation is improved. It is imperative that we have an effective regulator which is fit for purpose and able to intervene and deliver on its statutory objectives, most notably Consumer Protection.
3. Overall we would like to see **an end to light touch regulation and more effective and timely intervention from the regulator.**

Specifically this would include:

- a) **a greater appetite for enforcement action** – action should be tougher and prompter to punish poor behaviour and encourage firms to comply with rules. We expect the FSA to be more prepared and more willing to take enforcement action against senior management in firms

- b) **greater supervisory challenge to firms** –including interrogation of business models and clear accountability of senior management for the activities of the firm.
- c) **more transparency** where FSA is taking action with firms. We believe consumers have the right to know when the FSA is concerned about the behaviour of firms so that they might be better informed and more able to take appropriate action
- d) **the FSA should have regard to ‘value for money’ when discharging its regulatory responsibilities. We believe most consumers would view ‘value for money’ as an essential component of fairness.** An acknowledgement of this principle would help end the abuses of the kind we have seen in the Payment Protection market.
- e) **the FSA to be responsible for regulating consumer credit in the significant firms with which it has an ongoing supervisory relationship.** We believe this would strengthen protection for consumers and address possible confusion over regulatory roles. Trading standards officers would continue to be responsible for small retail providers of credit whilst major lenders would be accountable to one regulator for all their activities.
- f) **Greater product scrutiny** – Given the asymmetry which exists between consumers and firms and the fact that consumers will always lag behind providers when it comes to detailed knowledge, we believe that more attention should be paid to

the actual products, rather than as happens at present, to the appropriateness of the sales process. We believe more attention should be paid to the safety of the product, in particular to the risks inherent in financial products. We would encourage the FSA to make use of its powers in this area.

- g) In future, we would like to see an effectively regulated market which consumers trust and which works in favour of its customers, responding to their actual ( as opposed to created) needs i.e. by driving down costs, offering safer products and representing value for money.

## Overview

4. While we recognise that the drive for change is, primarily, to secure financial stability and more effective prudential supervision of firms, it is important that the impact on consumers is not neglected. In this financial crisis consumers are the largely innocent victims of management failure by others. The results of inadequate regulation and irresponsible behaviour by firms have cost consumers dear. Reduced income from savings; higher charges for credit and more limited access to mortgage finance, not to mention the cost to consumers as taxpayers of the banking bailout, have had serious and damaging consequences
  
5. Our contention is that while revisiting the regulatory framework is necessary, much of the failure of the system revolved around the behaviour of the regulator and firms, and the relationships between them. We believe that overall, the banking crisis has exposed the deficiencies of the 'light touch' approach to regulation. We wish to see reform which works for consumers and delivers better outcomes. The behaviour of firms illustrates that they need active regulation to prevent systemic risk and poor behaviour. We believe that in the past the regulator was slow, defensive and reluctant to take on the industry. We wish to see a much more interventionist and timely approach on the part of the regulator.

6. The regulator must however be empowered to intervene and give appropriate challenge to firms. This will mean that politicians must allow the regulator to do the job Parliament set it up to do. In the past politicians of all colours have been critical of the FSA as an over-intrusive regulator, most notably when Tony Blair said at the IPPR that the FSA is "seen as hugely inhibiting of efficient business by perfectly respectable companies that have never defrauded anyone". Indeed all mainstream political parties in the UK queued up to condemn the red tape that was strangling business. Against this backdrop the FSA was not sufficiently empowered in reality to challenge firms or prevent the growth of poor and risky business practice.
  
7. While an efficient financial sector is good for UK competitiveness, we would endorse the comments made in the Turner review that much of the innovation generated by the innovative capital markets was indeed socially useless. It is telling that the recent remarks of Adair Turner regarding the behaviour of the industry and the impact of financial services on the competitiveness of the economy have been challenged, which suggests that politicians and the City have failed to learn key lessons emerging from the crisis. We will be looking for reassurance that in future banks will receive rather less indulgence and that the FSA will be empowered to intervene.
  
8. As the debate has progressed, there is a perception that the FSA has been focused on conduct of business at the expense of prudential

regulation. We refute this absolutely. Conduct of business may indeed have been the primary focus of the FSA's work, but in particular we would challenge assertion at para 4.34 that 'at present the FSA's objectives are focussed on consumers; therefore the FSA has concentrated on the immediate impact on market confidence and the direct costs to consumers of financial services'. Even if this has been perceived as the primary focus of the FSA's work the FSA has not been as effective as we would have wished in tackling consumer detriment. Our view is that FSA has been much too slow in dealing with many examples of poor conduct in the retail market. We would like to see the FSA become much more fleet of foot in identifying and responding to emerging risks, both to the financial system and to the consumer.

9. We agree with Turner's analysis, endorsed by the White Paper that 'too much weight had been placed on ensuring that systems and processes were correctly defined rather than on challenging business models and strategies'<sup>1</sup>. We note the FSA's increased emphasis on outcomes and a willingness to scrutinise business models. The regulator will need to be more challenging towards the firms it regulates. What we wish to see is more regulatory intervention in order to guarantee compliance with rules and tackle those firms that are in breach, promptly and toughly, in order to deliver an effective regulatory regime; and which adequately protects consumers from risk to the financial system and from poorly behaving firms. This may require further amendment to

---

<sup>1</sup> Para 4.58 – Reforming Financial Markets, July 2009



FSMA to ensure that the FSA has the requisite powers to be able to take appropriate action. In respect of this we have been encouraged by recent changes at the FSA which we expect to improve its effectiveness in meeting the consumer protection objective.

10. This will require a **greater appetite for enforcement action** – action should be tougher and prompter to punish poor behaviour and encourage firms to comply with rules. There can be no incentive to comply with rules unless the FSA is seen to be taking action against those firms that are in breach of requirements. We note Hector Sants' recent comments that firms should be afraid of the FSA. Certainly, firms should be encouraged to take their regulatory obligations more seriously.
11. We expect the FSA to be more ready to take enforcement action against senior management in firms. Ultimately, senior management is responsible for the firm's behaviour and the buck stops with them. We note that the only senior management fine for mis-selling of PPI has been levied on the chief executive of a furniture retailer. This, in our view, is hugely disappointing.
12. We also wish to see **greater supervisory challenge to firms** –including interrogation of business models and clear accountability of senior management for the activities of the firm. If the FSA had used more business and micro-economic analysis and interrogated firms'

business models, for example, we believe that it would have identified the issues surrounding bank charges and PPI sales much sooner. The revelations of the discussions between the FSA and HBOS illustrate that even where the regulator had identified and pointed out issues surrounding the risks inherent in a firm's business model, it made no difference to the firm's behaviour<sup>2</sup>. As we said in our response to the Turner review, we will be looking for reassurance that firms and Government will consent to a philosophy of regulation which encourages effective regulatory intervention and puts the interest of the individual, taxpayer and consumer at its heart.

13. We also wish to see **more transparency** where FSA is taking action with firms. We believe consumers have the right to know about the shortcomings of the firms with whom they deal, well before the ultimate sanction of enforcement action by the FSA. As we said in our response to the Turner review, the FSA should name and shame firms who may be in breach of regulatory obligations. Consumers have a right to know more. Enforcement is not the only regulatory tool used by the FSA to change firms' behaviour and we would like to see the full suite of tools at the FSA's disposal deployed more transparently and more effectively.

14. Further we believe that the scope of the FSA should be extended to require it to **have regard to 'value for money' when discharging its**

---

<sup>2</sup> [http://www.fsa.gov.uk/pages/Library/Communication/Statements/2009/letter\\_chancellor.shtml](http://www.fsa.gov.uk/pages/Library/Communication/Statements/2009/letter_chancellor.shtml)

**regulatory responsibilities.** This would end the abuses of the kind we have seen in the payment protection market. Value for money considerations are important to consumers. What is clear is that in the wake of the crisis, competition is going to be less well equipped than before to deliver value for money in all circumstances. As it is we would dispute whether competition did in fact, produce significant consumer benefit and whether it did, in fact, deliver value for money. Clearly, further consolidation in the banking sector could impede effective competition.

15. We wish to see the **FSA become responsible for regulating consumer credit in the significant firms with which it has an ongoing supervisory relationship.** We believe this would strengthen protection for consumers. First, the involvement of both the FSA and the OFT in the regulation of day-to-day financial services such as retail banking leads to consumer confusion over respective regulatory responsibilities, as well as the risk of lack of effectiveness of the overall regime. The FSA is the lead regulator for financial services; it is responsible for all prudential aspects; and accordingly it would make sense for it to regulate all the consumer facing activities of the businesses that it authorises and with whom it has an ongoing supervisory relationship. The banking crisis was fuelled in part by irresponsible lending and through its prudential requirements and irresponsible lending rules, the FSA can do much to mitigate the risks of excessive credit expansion. Under our proposed regime trading standards officers

would continue to be responsible for small retail providers of credit while major lenders would be accountable to one regulator for all their activities.

16. Finally we would like to see the FSA make more use of **product scrutiny rather than the current reliance on sales processes**. Product design and pricing structures are also causes of detriment as well as selling practices. We believe that the FSA and the industry could do much more in this area to establish common standards of good practice and allow early withdrawal of risky or unfair products.
17. We also remain concerned about the long term signals given to the banking industry in the wake of the crisis. We have a system where banks make huge profits in the good times but benefit from an implicit taxpayer guarantee when things go wrong. Between them RBS, Lloyds and Barclays hold 77% of UK deposits and 40% of mortgages. We question whether such a concentration is, in fact, in the consumer interest and whether, despite taxpayers' support, such huge enterprises lead to effective competition that works in the consumer interest. We believe the size and concentration of these banks may require a review by the Competition Commission in due course.
18. We would also like to express our support for the proposed independent consumer education authority. We have questioned whether the FSA was the optimum home for financial capability for

some time although we continue to support measures designed to help consumers take more informed decisions. The FSA is not a sufficiently consumer-facing organisation to do this as well as it might. We therefore welcome the proposal for a new education authority although we believe it needs to be sufficiently independent in order to be able to do its job effectively.

## Consultation questions

### *Reforming regulatory institutions*

**1 What are the benefits in creating a more formal and transparent body to coordinate the authorities' more systemic approach to financial regulation? Do you have any views on the role and remit of the CFS?**

The proposed CFS is, in effect, a 'reformed Tripartite' and an acknowledgement that the existing arrangements between the Tripartite authorities were not fit for purpose.

We believe any changes to the Tripartite structure must establish clear accountabilities and address identified underlaps and overlaps. There must be absolute clarity about the respective roles, accountabilities and responsibilities of each of the authorities, and any new arrangement must deliver real 'added value', as opposed to adding yet another tangled and bureaucratic layer.

More significant than any structural change, however, is the importance of strong leadership. The responsibility for such leadership must rest firmly and rightly with the Treasury which needs to set policy which should then be implemented by the FSA and the Bank of England.

We believe that the CFS needs to operate in a transparent way and would hope to see the work of the CFS open to public scrutiny, including through the publication of minutes of the meetings. An appropriate model would be the Monetary Policy Committee which

publishes its minutes which brings much valued transparency to the decision-making process.

**2 To what extent would an annual report on key developments increase knowledge and awareness of significant regulatory actions taken under the Banking Act and FSMA? From your point of view, what areas would it be useful for this report to cover?**

A retrospective report, while interesting, runs the risk of being too late to enable effective, timely action. It is also likely that its content would in any case be covered by the FSA's annual report, the Bank of England's quarterly bulletin and other publications.

In our view the issue is not a lack of information, rather the failure to act on it. For example, the FSA's annual Financial Risk Outlook (FRO) was a valuable piece of work that was not properly acted upon by supervisors, firms or policy-makers. This was disappointing. We note that the FRO highlighted the risks posed by securitised products in successive FROs going back to 2005 and warned 'as firms take on more risk through complex and relatively illiquid instruments, risk management may become more difficult and operational risks are likely to increase.'<sup>3</sup> The warnings were available and signalled but were simply not acted on by the regulator, firms or policy-makers.

We are therefore, more concerned at the failure to respond to existing reports and market intelligence which would have signalled to the

---

<sup>3</sup> FSA Financial Risk outlook 2005.

Tripartite authorities that they should have taken action to mitigate the financial risks in the economy. Essentially the FRO, together with the Bank of England's quarterly bulletin, should inform much more effectively on how all players are mitigating the risks posed by economic indicators and market developments.

We believe that rather than reinventing the wheel, the Treasury should consider how best to make sure that regulators and firms act on the intelligence provided by the FSA and the Bank. We would like the FSA to ensure that supervisors use the intelligence on emerging risks in their discussions with firms.

The Consumer Panel would also like to see the publication of more regular and more focused FROs which drill down in more detail on particular areas of risk. We see merit in an FRO which focuses on risks being created in the retail sector. Publication of the FRO is an opportunity for the regulator to get the perceived risks out in the public domain and so enable consumers and consumer advocates to take action to protect their interests.

**3 In addition to the input of non-executives from the governing bodies of the FSA and the Bank, what other ways could external advice and commentary be incorporated in this process?**

We believe that there was ample advice regarding the risks, as outlined above. The failure lies not with a shortage of advice but in failure to recognise the issues and take effective action.



The Walker review has proposed a number of positive reforms to corporate governance in banks to enable and empower non-execs to do an effective job. We believe that these could be usefully read across to the FSA to see whether non-executive directors at the FSA have the time and resource to do the job effectively. There is a case for an independent one-off review of the Board's handling of the financial crisis to examine whether further change is required. We recommend that this is considered.

**4 What mechanisms might be used for enhancing democratic accountability? Is this important? Are there any risks that need to be considered – for example, around market sensitivity, or threats to consumer confidence?**

Ultimately the responsibility for the performance of the regulatory structure rest with the Treasury and the Chancellor of the Exchequer and the democratic accountability will be exercised by the voters at the ballot box. As we have mentioned the minutes of the CFS could be put into the public domain to increase the accountability of the process.

In addition, the new Consumer Education Authority proposed in the White Paper may have a role to play here. Informing consumers about emerging risks and possible actions they can take in response could be an important development in enhancing democratic accountability. Concerns about market sensitivity, while obviously important, should not be used to prevent useful information/data being made available.

This underlines the need for the authority to be sufficiently independent.

**6 What are the advantages and disadvantages of amending FSMA to make clear that the FSA must take into account any possible wider economic and fiscal costs in its decision-making?**

The FSA must take into account the wider economic and social costs in its decision-making. It should also consider the benefits of action. It may well be that significant costs may arise from a particular action, but if there are correspondingly significant benefits the costs should not constrain the ability of the regulator to react.

The crisis has proved that in the current market conditions and political environment, there are some firms which simply will not be allowed to fail. Given that the taxpayer is now established as lender of last resort, the Tripartite authorities have a duty of care to the taxpayer to minimise their exposure and help deliver positive exit routes in future.

This said, we would be concerned if, by being required to take account of wider consequences, this might lengthen and complicate FSA action. For example, the FSA might find evidence of consumer detriment but in straightened economic circumstances, might find it difficult to take action against a firm that is in the consumer interest. Arguably, the FSA can be a more effective regulator if its responsibilities are kept to the narrower focus of micro-prudential and behavioural supervision, rather than a broader remit for financial

stability.

**7 What are the advantages and disadvantages of amending FSMA to place a duty on the FSA to promote sound international regulation and supervision?**

The financial crisis has shown that no country can operate in a vacuum. At the EU level, the Panel has long called for improved regulatory cross-border cooperation in areas such as passporting, tackling fraud and for improved cross-border redress systems.

We would support an amendment to FSMA to place a duty on the FSA to promote sound European and international regulation, supervision and regulatory cooperation and, in particular, to promote best practice and the principles of transparency, independence, accountability, good governance and consumer consultation and representation.

We would also like to see an amendment to require that the activities of the FSA take into account the need to contribute to the development of the European internal market. An obligation on these lines already exists on the telecoms regulator under the Communications Act 2003.

The Panel has set out its views on the future structure of European financial supervision in its response to the recent Commission Communication

**9 Do you agree that the FSA's rule-making power and powers of intervention should be explicitly deployable in pursuit of any of its regulatory objectives and not just that of consumer protection?**

We agree with this and believe that in practice they are.

**10 To what extent will the FSA's enforcement capability be enhanced by a power to suspend individuals or firms for misconduct?**

This would give the FSA powers to stop approved persons or authorised firms from carrying out their role, or a specific activity, for a defined period. We believe this would be a valuable addition to the FSA's regulatory toolkit. We would like to see the FSA deploy its powers more readily, particularly in cases where complaints to the FSA or to FOS indicate systemic misconduct.

For example, the case of Payment Protection Insurance illustrates that the FSA has been unwilling to use the full suite of tools at its disposal. As far back as 2004, the FSA found poor selling practices, but progress in tackling this has been very slow.

We note that the FSA has given notice that it intends to take action against senior management more often, as it is now believed that this is a better way of ensuring that firms become compliant. However, we have seen limited evidence that this is happening. We note that the only Chief Executive of a household name to be directly penalised for PPI is a furniture retailer<sup>4</sup>. Given obvious market abuse, this is disappointing.

---

<sup>4</sup>FSA/PN/039/2008 12 May 2008 – FSA fines Land of Leather and its Chief Executive for PPI failings

There are further changes we would wish to see in order that the FSA's enforcement powers are strengthened. We would like to see it made public when the FSA initiates enforcement action against a firm. This could be done when Enforcement's enquiries are sufficiently advanced to indicate that there is definitely a case to answer.

At present enforcement actions are only disclosed once they have run their course, the case has been heard, and the penalty finalised – or when a case has been appealed to the Markets Tribunal. This can take many months or even years.

We see no logical reason why the FSA's conduct should not be the same as that in the wider criminal justice system, where a person charged with an offence is publicly identified in the initial stages of proceedings, and the existence of the case does not remain secret until it is concluded.

We believe that customers and potential customers have the right to know whether the firms they are dealing with have been judged by the FSA to be in breach of the rules. We believe this transparency would help protect consumers, who, under the present system, may well find out too late that the firm they have trusted has in fact long been the target for proceedings by the FSA.

**11 To what extent will the FSA's enforcement capability be enhanced by a power to penalise persons who perform a controlled function without the necessary FSA approval?**

At present the FSA can only impose a penalty upon a person who has been approved. Therefore a person can simply evade an FSA penalty by simply not seeking approval. This will close down that loophole and should be welcomed.

We also believe that the FSA should be more ready to bar from future authorisation, either permanently or for a set term, any individual who personally carries out a controlled function without FSA approval, and we believe that the maintenance of a public register of such persons would have a beneficial deterrent effect.

**12 Are the Government's proposed amendments to FSMA the best way of ensuring that the FSA can continue to take effective action to tackle abusive short-selling practices?**

We continue to support the FSA's efforts to tackle abusive short-selling.

**14 What are your views on this proposal to expand the role of the FSCS?**

We support the proposals as they affect the FSCS. It is important that consumers find it easy to be compensated and this will be expedited most effectively through dealing with the compensation scheme in the

country in which they live. Expanding the role of the FSCS to act as the agent for compensation schemes in other countries when they have to pay compensation to UK consumers is therefore useful.

*Competitive Markets that work for consumers*

**15 What are the advantages and disadvantages of the relevant consumer credit firms contributing to the costs of Money Guidance?**

There are considerable advantages in extending the liability to all consumer credit firms as irresponsible lending practices are one of the major causes of consumer detriment. Whether this would be advantageous however would depend on the size of the levy. If the levy were too large it would be anti-competitive and a tax on consumers who will ultimately foot the bill when the industry passes it on to them.

**16 The Government believes that some organisations, such as free and impartial debt advice providers, should be exempt from the levy on consumer credit licence holders – do you agree? Are there other cases where an exemption is appropriate?**

We support the proposal that independent debt advice agencies should be exempt from the levy.

**17 What factors should be considered in designing an appropriate levy scheme for consumer credit firms?**

Ultimately the levy will be borne by consumers so the scheme should

not be unduly costly or burdensome.

### **18 What issues need to be resolved to establish a successful consumer education authority set up by the FSA?**

We welcome the proposal for the creation of a new authority. The FSA is set up to deal with firms and, in style, does not find it easy to engage with consumers. The new body needs to be genuinely consumer facing and able to communicate in a style which is well understood by consumers of all incomes, backgrounds, and existing levels of financial capability. It should also have a consumer friendly brand with a more user friendly identity than 'consumer education authority'.

Fundamentally we believe that the new body must be firmly positioned as on the side of the consumer. This will mean that at times it will be brought into conflict with the industry, and indeed on occasion with the FSA and other regulators and policy makers. It may even, in the short term, be open to the accusation that properly informing consumers could threaten market confidence in a particular firm. Whilst it is of course important to consumers that there is general confidence in the UK financial services system, we think it will adversely limit the scope of the new authority if it is regularly unable to tell consumers the information that they need to know to best manage their relationship with firms or with the financial services industry. The accusation that the release of information and guidance



will threaten market confidence will also be an easy option for firms who wish to try and limit criticism from the new authority.

We have also heard the argument that there might be extreme situations (e.g. the 2008 concern about the safety of some bank deposits) where a threat to the entire UK financial services industry would require that the new authority is cautious in what it says. But the basis behind the new approach to reforming financial markets, and the regulatory authorities' more systematic approach to financial regulation is to address such extreme situations before they impact on firms and consumers. We therefore hope and think it unlikely that the new authority will be faced with such a dilemma.

Nevertheless, we presume that the tripartite authorities will want some reassurance that the new authority would have regard to national financial stability where the new regulatory structure identifies that there is a systemic threat. We think that governance should provide for guidance to the board of the new authority at any time when the regulatory authorities are concerned about an immediate threat to national financial stability.

We believe that the new service must be sufficiently robust and supported by its independent governance structure to resist industry and regulatory pressure not to be critical of firms' or industry practices. In the longer term, it will be of benefit to consumers, firms and the UK financial services system that consumers are helped to

better identify their needs for financial products and to choose between such products.

The remit for the new authority needs to be clear and precise. It should set down what the authority is expected to achieve, and how these outcomes will be measured and reported. Within these outcomes, the authority will have to develop and take lead responsibility for the National Financial Capability Strategy and the roll out of the new Money Guidance service. This requires a delivery plan with identified milestones.

Moreover, the remit must be clear as to how the new authority relates to the numerous existing financial services education and information initiatives provided by various statutory authorities, For example, there may be efficiency arguments in favour of the new authority taking the lead on existing consumer education roles such as the OFT's Save Christmas Campaign or the work of the DWP's Financial Inclusion Champions. If the new Authority does not take on these roles it should have strategic responsibility for the co-ordination of consumer education across the UK, including working with the devolved administrations.

Crucially, it must be clear what role is expected of the new authority in providing information and guidance on pensions. We have not given any consideration to whether we think it best that the DWP, the Pensions Advisory Service, the new authority, or another body should lead on providing consumer information and education on, for

example, personal accounts. But we are clear that there is a need for clarity on which agency will lead given the importance of pensions and the future changes.

**19 What are your views on the scope of the new authority? Should it also, for example, champion consumer interests and act as a consumer voice in financial services?**

We believe the new authority should act as a consumer champion in so far as it should highlight issues for consumers both publicly and to the regulator. We do not believe it should be a campaigning organisation and we note in any case the proposal for the creation of a consumer advocate which we believe will discharge this campaigning function.

The new authority has to be trusted by the public and all consumers. Its role has to be impartial, independent and to 'tell it how it is'. Its relationship with industry is important but overall it has to be an agency that is in favour of consumers, not lobbying on their behalf but providing consumers with the information, awareness, skills and capability to make informed choices. The new authority shouldn't shy away from maximising its impact with consumer alerts, information campaigns, comparison tables and explaining what consumers need to know, for example how to understand and make judgements on complaints data.

**20 What are your views on the governance and funding proposals for the new authority?**

As previously mentioned we believe that the new body should be genuinely independent of the FSA. We note that the White Paper will require the authority to be set up by the FSA and we feel strongly that there should be sufficient freedom as to guarantee the authority's operational independence.

We welcome that the authority will be funded by a levy on firms.

### **21 To what extent should the authority be independent of the FSA?**

We repeat our call for the authority to be fully independent of the FSA. We believe that the separation of roles will enable the new authority to be genuinely consumer facing. Governance must avoid overlap and must allow the authority to be effectively challenged over how it discharges its role. We would welcome the Treasury Select Committee having a scrutiny role over the new authority.

### **22 How can better routes to collective redress be achieved, which deal with claims more efficiently, reduce the time that claimants may have to wait, and reduce the volume of individual cases dealt with by the courts or FOS?**

The experience of the Consumer Panel is that existing arrangements for achieving collective redress are unsatisfactory. The Panel therefore welcomes the Government's intention to improve the arrangements. The Panel considers that the main route to collective redress should be via the action of the FSA as regulator of the financial services industry. Action through the courts, while appropriate for failures in the

provision of the generality of goods and services, should not be necessary where an industry regulator has been put in place with responsibilities to protect the interests of consumers.

The Panel does not agree with the view, expressed in para 8.63 third bullet, that because its resources are limited, the FSA might conclude that consumers should seek redress through the FOS or private proceedings. While reference to the FOS is suitable for individual complaints, this route is not effective when large numbers of consumers are complaining about the same issue. Where there are such large numbers, the FSA should accord the matter high priority for that very reason. We welcome the current review of the 'wider implications' process and look forward to an outcome that ensures emerging problems are nipped in the bud, thus obviating the need for retrospective collective redress. We would like to see more effective working with the FOS on past business reviews so that consumers can be confident that the redress mechanisms are fit for purpose. The key principle must be that consumers should be free to choose the way in which they seek redress.

**23 What are the pros and cons of updating FSMA section 404 through expanded new powers for the FSA to which different procedures will apply as proposed?**

The Panel endorses the proposal to updating FSMA section 404, including expanding its scope to cover all areas where the FSA has regulatory responsibility. We believe this will go a long way to tackling

the problems arising from the present arrangements. We look forward to commenting on the detailed rules in due course. We would like any revision to provide for easier facility of redress for large numbers of consumers without them being required to formally complain. This will encourage firms to correct detriment more quickly.

**24 What are the pros and cons of introducing a new representative action process where there is evidence of a breach of FSMA or FSA rules, and should this extend to breaches of other requirements in the area of FSA supervision?**

It is important that the FSA is an effective regulator and takes prompt and decisive action where detriment is identified. If the regulatory system was effective, there would never be any need for consumers to seek recourse to the courts.

Again however we would emphasise that it is important to provide a range of redress routes from which consumers can choose. We recognise that making provision for class actions might make the FSA less inclined to take appropriate action, and might instead let matters be resolved in the courts. The recent history of the bank charges case illustrates that letting matters go to the courts just delays the process of obtaining redress for consumers. However, there may still be circumstances in which a class action is appropriate and the best route for consumers.

If there is a provision for a class action, then the regulator should not be allowed to veto it. The courts should be the ultimate arbiter of whether an action is appropriate. The fact that a class action is necessary shows that the regulator has, probably failed to act.

While we do not object to improving the scope for redress through the courts, we would not wish to see this as a general alternative to action by the FSA under an amended s404.

## **26 The Government invites views on the potential costs and benefits of its collective redress proposals.**

If regulation were more effective there would be no need for collective redress. However, it would be appropriate to provide alternative means of redress including through class actions to provide for situations of widespread detriment where the regulator has failed to act. We note the proposal to create a consumer advocate to instigate class actions and we believe that it ought not to be the case that large groups of ill treated consumers should meet the costs of court action.

### *Barriers to Entry and Simple products*

## **5 What steps could the Government take to increase competitive pressures in the market, to the benefit of consumers?**

This is a market which has lacked effective competition and where innovation to benefit consumers has been inadequate. While other retail sectors have seen enormous change over the past century, the

same players continue to dominate, arguably to the detriment of consumers. Indeed, creating huge organisations deemed ‘too big to fail’ can work against effective competition and the interest of consumers.

The OFT found that the following factors acted as barriers to competition:

- The need to establish a branch network;
- A successful brand;
- A low customer churn rate;
- Access to payment networks
- Regulatory requirements; and
- Access to customers credit risk information

The need to establish a branch network is clearly punitive but collaborative working with other retailers and organisations, together with the opportunities afforded by technology, may provide an opportunity to address this. It is important though that regulation keeps pace with the opportunities afforded by technological change.

Competitive pressures will be enhanced through better consumer information and education. We have consistently asked the FSA for more disclosure, for example naming and shaming those firms that are guilty of regulatory breaches.

However we would challenge the implicit suggestion that increasing competition would necessarily be the most effective way of bringing benefits to consumers, particularly if the nature of competition



continues as before. Indeed the barriers identified by the OFT illustrate that the role of competition will be limited.

We therefore believe that the FSA should be required to have regard to value for money when discharging its regulatory functions. Consumers need value for money if they are to feel fairly treated and be willing to engage with the financial services industry. Industry has failed to provide value for money in many cases, for example:

- Bank charges
- PPI excess profits
- Personal pensions – inefficiency leading to high transaction costs, hence Personal Accounts
- Plethora of packaged products with high transaction costs

We can see a role for the FSA in delivering value for money by progressing through a number of stages of which price setting would be the final tool.

In the first instance the nature of effective competition needs to be explored and encouraged as a means of driving down costs for the consumer. In the absence of fair competition, the regulator can use other supervisory tools. For example price-capped benchmark products (e.g. Sandler) can be made available and with an obligation that where they are not sold firms must justify why another product is more suitable. Similarly review of sales practices and incentives can

be used where there is a risk of mis-selling. This will require very active supervision of the behaviour of the firm and how it conducts its business in order to identify the key areas of risk. The FSA could then retain the power to cap prices where competition and existing products have manifestly failed to deliver value for money for the consumer.

## **7 How can the Government and industry facilitate easier account switching in the retail banking sector?**

Consumers would, we believe, be more inclined to switch if they perceived true differentiation in product offerings. We doubt this is the case. As we have highlighted previously, the lack of true differentiation and effective competition has worked against consumers.

We therefore, question whether brand switching is a reliable measure of competition. While there is a need to facilitate ease of switching, the restricted number of banks and lack of product differentiation limit customer choice and often discourage consumers switching to a better offering.

However we note the provisions which allow customers to port their phone number between mobile phone providers. We believe that this methodology could offer useful lessons to enable switching between account providers.

We also believe that there should be better, more upfront and obvious

information on bank statements in order to facilitate greater transparency and enable consumers to compare the services of different brands and, specifically, varying interest rates.

**10 Do you support the Government's proposals to embed facilitating market entry into medium-term financial sector policy making by requiring the FSA and OFT to specifically address the issue in: Cost Benefit Analysis on new regulatory proposals; and the OFT's annual updates to its financial services strategy?**

We welcome any steps which serve to facilitate new entrants into the retail banking market. Because this market has suffered from the lack of effective competition, we would value the impetus and innovation which could arise from new entrants focusing on meeting real customer needs and embracing 'fairness' in their treatment of customers.

**11 Would you support requiring the OFT to consider enforcing the adoption of industry-wide disclosure standards to ensure consumers are well-equipped to make decisions about their financial affairs and to switch suppliers?**

We broadly support this, in so far as it makes consumers better equipped to make decisions but we acknowledge that there can be issues with how information is disclosed to consumers. We would therefore urge careful consideration and testing of any such proposed standards to check their helpfulness for consumers ahead of full implementation. While improving disclosure and encouraging

consistent standards and meaningful terminology are important, disclosure should not be viewed as a panacea. While it may help consumers become more informed and take better decisions, this is always going to be a market where consumer knowledge will lag behind provider knowledge. There is a considerable body of research which illustrates the limits of disclosure in empowering consumers

**12 Would simplified labelling help consumer understanding of financial products? What lessons can be learned from the traffic light system of food labelling and how can these be applied to financial products? Should such labelling be compulsory?**

We appreciate that finding labels to describe the nature of a financial product is difficult. For example if a system is based on traffic lights, the vast majority of products would be labelled as amber – few being considered very safe and few very risky. We do not believe therefore that a system based only on traffic lights would be helpful. We think that additional supporting information is needed to provide context and additional clarity. We welcome the current research being conducted by the EU into labelling and understanding of risk. While as a Panel we welcome any moves which improve customer understanding of the nature and risk inherent in products, we urge caution in adopting too simplistic an approach.

**13 Which products would – and would not – be suitable for simplified labelling? Is it possible to establish a single system of disclosure for a diverse range of products?**

We are, as a Panel, increasingly interested in looking at product scrutiny and design to tackle potential consumer detriment. We believe if risks could be mitigated through the development of more straightforward products which gave consumers more confidence, consumers would be encouraged to engage more with financial services. Consistent language must be used to explain risk to consumers.

There can be consistent disclosure requirements for similar types of product; for example, common ways of expressing the APR etc. We would, therefore, welcome more consistent terminology for similar product types, to help understanding and comparisons. But again, we would caution against adopting too simplistic an approach. There is no such person as an 'average consumer' and levels of understanding and capability vary enormously.

#### **14 Should price be benchmarked? Should there be disclosure to help people identify products which are relatively expensive?**

Benchmarking could be helpful and would highlight where price was out of line with industry practice. Yet, again we would caution against too simplistic an approach. Consumers find it very difficult to understand the compounding effect of small % differences in charges, particularly when long term forecasts can not be made at the time of sale. More understanding of, and research into, the advantages and practicalities of benchmarking would be useful.

#### **15 Why do some existing simple products not sell well?**

Basic products have low margins and therefore are not attractive to be marketed by the industry, although they may very well appeal to consumers. It remains the case that products are sold not bought, and therefore the industry will not push products which are low in margin relative to the cost of providing advice. Hopefully, the implementation of the FSA's Retail Distribution Review and the imminent demise of product, sales and provider bias will help customers understand the true benefits of a product, as opposed to sales persuasion dictated by commission.

Moreover, the introduction of Money Guidance and signposting to particular products may make simple products more attractive to providers. For example, the cash ISA is a popular product. This may be because people do understand the tax treatment of their savings and there is an intense period of marketing and sales which generates sufficient volume for them to be profitable.

**16 Should the Government extend the concept underlying RU64 to other products – i.e. require firms to demonstrate why a complex or expensive product is better than a simpler or cheaper alternative?**

We believe that the rules surrounding suitability should deal with this, where less complex benchmark products exist.

**17 Who should set benchmark standards for products?**

They should be set by a not-for-profit body. Trade associations can play a role here, for example SHIP has established good standards in

equity release products and lifetime mortgages. The FSA should however provide regulatory oversight.

### *Compensation*

**20 Do you have any views on how the governance and accountability of the FSCS can be strengthened to help it successfully deal with these new challenges?**

Our priority is to ensure that the money is adequate and available to allow consumers to be compensated. The governance and accountability should ensure that this is the case.

**21 Do you agree that a single point of contact would be a suitable way of handling cross-border compensation issues in the EU? If not, why not and what alternative would you suggest?**

We agree and we believe that single point of contact should be the regulator closest to the consumer to enable ease of contact.

**23 Should there be more or less harmonisation of EU deposit-guarantee schemes?**

We believe that the EU should set a minimum level of protection, not a maximum.

**24 What are your views on the possible introduction of a pan-EU deposit-guarantee scheme?**

We do not believe this is necessary. Rather we should ensure that

relationships between cross border protection schemes function effectively.

### *Strengthening Mutuals*

**28 Are there other measures the sector or Government should consider to achieve the long-term aim of a robust, thriving building societies sector?**

We believe that the Compensation scheme has worked to the disadvantage of mutuals and hope this will be addressed. Mutuals have traditionally offered a less risky business model and have been bearing a disproportionate burden for meeting the costs of the bailout.

**32 Are there other measures that the Government should consider to enable credit unions, IPSs and friendly societies to thrive?**

Credit Unions and Industrial and Provident Societies including Community Development Finance Institutions make a valuable and important contribution to improving the access to affordable credit and financial services for many people and especially for those on low incomes.

The Panel welcomes the additional resources allocated by the Government to the Growth Fund thereby allowing the sector to offer more affordable loans during the economic recession.



We welcome the proposals as set out in the Co-operative and Community Benefit Societies and Credit Union Bill, we believe this goes some way to create a more 'level playing' field for the sector. The announcement that the Government is consulting on a Social Wholesale Investment Bank is one we support: access to long term and less expensive funding is critical to the financial sustainability of the sector.

However, we do believe that more could be done to support the sector including considering the co-location of credit unions within other Government agencies, like Job Centre Plus Offices or J P surgeries, for example, or to explore possible closer working relationship between the sector and the Post Office Network, particularly in rural areas. Improved guidance and even financial incentives for local authorities to use powers of community well being as a means to support local credit unions and community banking arrangements. We see the roll out of key Government programmes like the Savings Gateway and the proposed National Money Guidance service as effective interventions that have the potential to assist in the future development of the sector.

Adam Phillips

Chairman

30 September 2009