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

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Response to A new approach to financial regulation: Building a stronger system, April 2011

Executive Summary

We welcome HM Treasury's second consultation paper on the reform of the regulatory system and the opportunity to shape a more effective, focused regulatory system that delivers good prudential regulation and enhanced consumer protection. The consultation paper expands on many of the issues that we identified in our previous response[1]. We approve, in particular, of the following aspects:

- The opportunity that arises from a twin peaks structure to have a dedicated consumer protection agency focusing on conduct issues.
- A strengthened focus on competition, with the proviso that this could be made clearer and supported by full competition powers.
- A greater commitment to transparency, provided this is accompanied by rules that support reputational regulation and greater accountability of the regulator.
- The judgment-based approach to regulation, which will allow the regulator to intervene proactively to prevent detriment before it has materialised.
- A product intervention power to stop products that are not fit for purpose and have the potential to cause detriment.
- A commitment to have regard to wider sources of information and to engage more directly with consumers.
- A continuing role for the FSA panels.

However, there are still some significant regulatory gaps in relation to financial inclusion and access and in relation to non-financial businesses that rely heavily on banks. We encourage further consideration of the way in which the draft bill should effectively address these weaknesses. We propose that the FCA's consumer protection operational objective be amended to read: "securing an appropriate degree of protection and access for all consumers" and that the power of super-complaint be widened to include organisations representing small and medium non-financial businesses.

Our outstanding concerns centre on governance and accountability of the regulatory regime and the comparative powers of the regulators. We propose the following mechanisms to achieve greater co-ordination, accountability and balance between the PRA and FCA while preserving a circumscribed power of veto in relation to the disorderly failure of firms:

[1] A new approach to financial regulation: judgement, focus and stability. The Financial Services Consumer Panel Response to CM 7874, October 2010.

1. The PRA veto should be exercisable only in relation to the disorderly failure of a firm or firms and not in relation to "wider systemic instability"; if there were concerns about systemic instability the right of veto should lie exclusively with the FPC.
2. To resolve veto disagreements not associated with a general financial crisis, the PRA or FCA should have access to the FPC, which would arbitrate.
3. The PRA should be subject to a "have regard" to minimise the adverse effects of its activities on competition.
4. There should be an effective managerial incentive structure and an internal audit process to encourage co-operation and the free flow of information between the PRA and FCA.
5. The Treasury Committee should report annually on the FCA and PRA, and how well their activities are co-ordinated.
6. The FCA should submit bi-annual reports to BIS and HM Treasury, comparable to the bi-annual stability reports by the Governor of Bank of England.
7. The PRA and FPC should be formally required to consider representations from the Consumer Panel.

We note the concurrent consultation on the regulation of credit and hope that at the next stage there will be an opportunity to bring these consultation processes together. It is important to consider the implications of bringing the regulation of credit into the FCA as part of the changes set out in this document.

Bank of England and Financial Policy Committee

1. **What are your views on the likely effectiveness and impact of these instruments as macro-prudential tools?**

   In its deployment of macro-prudential tools, the FPC will be required to take account of the effect of its actions on the capacity of the financial sector to contribute to UK economic growth and to be proportionate, but is absolved from the requirement to conduct a formal cost-benefit analysis. Absent from these proposals is a sufficiently explicit requirement for the FPC to consider the impact of its actions on consumers' welfare. Instruments such as loan-to-value caps or enhanced regulatory capital requirements introduced, for example, to avert an emerging housing market bubble may be effective in stabilising the financial system, and therefore of general benefit to consumers, but may in addition limit consumers' access to financial services and raise their cost. It is not self-evident that the proposed constitution of the FPC would provide adequate breadth of experience and independence of thought to ensure that these specific consumer concerns were taken into account.

   We believe that the FSA should be required pro-actively to engage with the interim FPC to subject macro-prudential tools to a rigorous cost benefit analysis in order to evaluate the effect of each tool on financial stability *and* consumers' welfare. This preparatory exercise would facilitate the selection of preferred macro-prudential tools that would contribute most to financial stability while inflicting least collateral damage on consumers, judged in terms of the impact on the availability and cost of financial services. Except in circumstances of immediate crisis, we would also expect the FPC, once fully operational, to consider in consultation with the FCA the consumer welfare implications of macro-prudential interventions.

   We particularly support the use of information disclosure as a macro-prudential tool. There should be a constant flow of information from the regulators to the FPC, and the power to direct the regulators to require firms to disclose certain information is an important supplementary power.

3. **Do you have any general comments on the proposed role, governance and accountability mechanisms of the FPC?**

   The FPC will be a sub-committee of the Court of the Bank. In addition, a majority of the members and the Chairman will be drawn from the executive management of the Bank. In our view this does not provide the necessary checks on the decisions taken by the Bank's executive management. We think that a majority of members should be from outside the Bank. These non-Bank executives should be properly supported and resourced to guard against the phenomenon of "group think". In normal circumstances this will provide the necessary independence to consider actions proposed by the Bank, the PRA and FCA and decide on the best course. In an emerging crisis, where decisive action is important, it is extremely unlikely that the independent members will overrule the advice of the bank's executive. In that respect the experience of the recent crisis has been reassuring.

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The Monetary Policy Committee (MPC) provides an example of greater transparency and accountability of operations within the Bank of England and, allowing for the different functions, could be a model for the FPC.

The MPC goes to great lengths to explain its thinking and decisions. In addition to the publication of the minutes of meetings and the discussion leading to decisions they also record the votes of the individual members of the Committee. The Committee has to explain its actions regularly to parliamentary committees, particularly the Treasury Committee. MPC members also speak to audiences throughout the country, explaining the MPC's policy decisions and thinking. This is a two-way dialogue. Regional visits also give members of the MPC a chance to gather first-hand intelligence about the economic situation from businesses and other organisations. We would encourage the FPC to adopt a similarly transparent approach in its engagement with stakeholders.

The Panels have traditionally had a worthwhile dialogue with non-executive members of the FSA Board, providing information and particular perspectives, and we propose that this ongoing dialogue should continue with the FPC. We believe that a formal relationship with the Panels, similar to that proposed for the FCA, would be a useful addition to the governance arrangements for both the FPC and PRA. This could be achieved as part of the MoU between the FCA and the FPC and PRA.

Prudential Regulation Authority

5. What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the PRA?

(i) Strategic and operational objectives

Competition

The omission of the former general duty to have regard to the impact of regulatory activity on competition does not affect the FCA, as long as it has its enhanced competition objective, but does raise the danger that regulatory intervention undertaken by the PRA may have a damaging impact on competition and consumers' welfare. Concentration or a regulatory preference for larger institutions raises concerns about barriers to entry and creates the risk of imperfect competition. It is no doubt easier for a regulator to regulate a small number of firms with a similar operating model. If the PRA only focuses on financial stability it may lose sight of the long-term impact of its activities on the competitive structure and behaviour of financial firms.

This danger was taken so seriously that Cruickshank (1999)[2] proposed the FSA be responsible for making the trade-off between regulatory and competition outcomes in financial services. He proposed that the FSA be given a *primary* competition objective to minimise the anti-competitive effects of its regulatory activity.

[2] Cruickshank, D. (1999), *Competition and Regulation in Financial Services: Striking the Right Balance*, July.

We are not minded to propose a Cruickshank principle for the new twin peaks structure. It may be difficult for the PRA itself to make a competition-stability trade-off, and the elevation of competition to a primary PRA objective could lead to muddle and possibly to industry gaming of the regulatory rules.

We nevertheless believe that a competition check is required on the PRA's activities. The existence of the FCA provides a primary check, but the power balance between the two organisations as proposed would not produce satisfactory consumer outcomes. We appreciate the strengthening of the duties of the authorities to consult and co-ordinate and believe that this could be better delivered if there was an obligation on the PRA to be mindful of the potential for adverse impact on competition when making its decisions. We therefore propose adding the current "have regards to" applying to the FSA to the PRA's regulatory principles:

"the need to minimise the adverse effects on competition that may arise from anything done in the discharge of the PRA's functions".

Co-ordination of business model analysis

The PRA and FCA will have a different regulatory emphasis because of their different obligations but they should have a common way of analysing business models to serve both sets of objectives. To avoid duplication and waste, we propose there should be a common template for the gathering of information on firms' business models and effective co-ordination of supervisory visits from both PRA and FCA.

(ii) Regulatory principles

We address the common regulatory principles under question 11.

7. **What are your views on the mechanisms proposed to make the regulator judgement-led, particularly regarding: rule-making; authorisation; approved persons; and enforcement (including hearing appeals against some decisions on a more limited grounds for appeal)?**

We welcome the adoption of a judgement-led supervisory approach by the PRA and see this as significant in moving the regulator towards a more proactive approach in which activities that pose unacceptable risks are curtailed in advance of evidence of widespread detriment. We believe that, although the FSA has had extensive powers, its supervisors have been unduly hampered in their efforts to impose regulation swiftly by the arguments about the interpretation of rules and principles.

In circumstances where the regulator is acting in good faith and observes due process the grounds of review to the Upper Tribunal should be on those limited grounds that apply to judicial review, and not a full and costly review of merits. There needs to be efficiency, certainty and finality of decision making.

8. What are your views on the proposed governance framework for the PRA and its relationship with the Bank of England?

and

9. What are your views on the accountability mechanisms proposed for the PRA?

The PRA will effectively act as a division of the Bank. The governance reflects that. We would reiterate our concerns expressed in answers to questions 3 and 6; that the FPC needs to have a majority of independent members, in order to provide effective oversight of PRA decisions which could have a wider impact on stability, economic growth and consumers' welfare, and that the FCA proposed advisory panels could provide a broader perspective and useful advice in the area of business model sustainability and competitive effects.

10. What are your views on the Government's proposed mechanisms for the PRA's engagement with industry and the wider public?

The proposed mechanisms for engagement of the PRA with the wider public or on broader issues are inadequate. Parliamentary scrutiny will not be sufficient or even alerted to issues with the regulator if there is no provision for greater public scrutiny. Leaving accountability to complaints after the event will not play the crucial role of providing information for decision making.

The Panel supports the continued use of consultation in rule making but believes that more comprehensive cost-benefit analysis could materially improve the quality of rule changes proposed by both the PRA and the FCA. We would like to see much more emphasis on the quantification of *consumer* costs and benefits, in addition to the regular appraisal of the compliance and other costs faced directly by industry. These enhanced cost-benefit analyses need to be better resourced and provide robust and credible outcomes that are seen by both industry and consumers alike to be fully independent of regulatory policy making

The decisions of the PRA and its supervisory work have the potential to impact significantly on consumers, because of the power of veto over conduct regulation, the interactions between conduct and financial stability (eg the decisions taken to deal with an asset bubble) and the potential for detrimental practices to be endorsed in the name of financial stability (eg in a PPI type situation). It is vital that consumer interests are represented in its discussions. The presence of the chief executive of the FCA on the Board is not sufficient in our opinion. As already raised in relation to the FPC, we would like to see the Panels having a relationship with the PRA Board, as now with the FSA, which would enable us to be aware of forthcoming items on their agenda and the ability to submit observations and comments on issues which are being discussed where the experience of the people on the Panel may be relevant. This has been achieved through the requirement in s10 & 11 of the FSMA for the FSA to establish and consult Panels of consumers and practitioners and, for the panels to be able to raise issues formally with the Board and require them to respond. This process has never been used formally but, through the MoU under which the Panels operate, it has been possible to discuss issues and provide advice which has improved the debate on the Board.

In addition to external consumer input, the Consumer Panel currently plays a role within the FSA in relation to both prudential and conduct issues and also provides advice on matters applicable to both such as consumer engagement. The Consumer Panel works to advise and challenge the FSA from the earliest stages of its policy development to ensure the FSA takes the consumer interest into account. Members of the Panel encompass a broad range of relevant expertise and experience. The Financial Services Act 2000 provides that the FSA must have regard to any representations made to it by the Panel.[3] Translation of the formal recognition of the Consumer Panel to the PRA and FPC would enable early input and identification of possible consumer impacts or prudential regulation.

Financial Conduct Authority

11. What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the FCA?

(i) Strategic and Operational Objectives

Whilst we understand the desire to have a single focused objective the wording around the strategic and operational objectives and other related matters could be clearer in allocating responsibility and authority. We broadly support the objectives subject to the following considerations:

Consumer protection

It is our view that a conduct regulator must focus on consumer protection and delivering good consumer outcomes. Protecting and enhancing confidence in the system must be clearly linked with the consumer protection objective.

Competition

We support the greater emphasis on competition, both through the operational objective and in that the FCA must discharge its general functions in a way which promotes competition. The importance of competition to consumers has been re-emphasised in the recent Treasury Committee report on Competition and Choice, the BIS consultation paper on the competition regime and the Independent Commission on Banking's interim report. In particular we endorse the sentiments of the BIS consultation that it is necessary to maximise the ability of the competition authorities to secure vibrant, competitive markets that work in the interests of consumers and to promote productivity, innovation and economic growth. The paper proposes developing the regime's ability to resolve and deter the competition restrictions that do more harm to competition, consumers and to economic growth and providing the regime with the tools and flexibility to make proportionate and focused interventions. In allocating the FCA a competition function its powers and authority have to be equivalent to those of the sector regulators.[4]

[3] FSMA 2000 s10(4)
[4] BIS, A Competition Regime for Growth: A consultation on options for reform, March 2011, p6.

We therefore propose that the competition operational objective be strengthened as follows:

"The FCA must, wherever appropriate, promote effective competition that improves consumer outcomes in retail and wholesale markets."

Financial inclusion

In our response to the original consultation we proposed a "have regards" to the desirability of promoting financial inclusion, and for the new regulator to have an effective toolkit that will enable it to act appropriately as an economic regulator, including the power to intervene on charges. Although the current consultation paper rejects the suggestion that the FCA should have regard to the promotion of financial inclusion, it helpfully confirms that the FCA's efficiency and choice objective and the proportionality regulatory principle provide the mandate for the regulator to address financial inclusion (para 4.3).

It is no longer possible to function outside of the financial services system, not only in relation to transactional services but increasingly in pensions and insurance, as responsibilities in these areas pass from the Government to consumers. Access to financial services is a precondition to functioning in society and needs to be intermediated. Other sector regulators have a range of social duties and for most of these this includes a primary duty to further the interests of consumers.[5] The FCA should be no different in this respect and clear recognition needs to be given to its role in intervening to secure financial inclusion.

In order to better reflect the role of the regulator in this area we propose the consumer protection operational objective be amended to read:
"securing an appropriate degree of protection and access for all consumers".

Financial crime

We understand the proposal is to treat financial crime as a 'have regard'. Whilst there have been re-assurances that this is not a downgrading of the previous objective, it may be seen as such by both consumers and industry. If so, it would send an unacceptable message that the transition from FSA to FCA would lead to a reduction in efforts to combat financial crime. There may also be an adverse impact on the retention and recruitment of talented, public-service minded individuals who could earn much more in the private sector. We believe there is a need to be more explicit about the requirement to reduce financial crime, to assuage those who fear, possibly incorrectly, that the goal has been downgraded, and to safeguard this goal against future changes in regulatory emphasis.

The Panel further understands that in this context, the FCA will interpret financial crime as covering money laundering and insider dealing, and not as covering directly consumer related issues such as the unauthorised provision of financial services. We

[5] As above, p 72

would not want to see financial crimes that directly affect consumers drop off the agenda as non-priorities

We are aware that cuts to funding of the Serious Fraud Office and to the justice system will affect the ability of other bodies to pursue enforcement and prosecutions. It is therefore crucial that adequate emphasis, enforcement powers, and resource is provided to the FCA in this area.

In the absence of any assumption of such responsibilities by the SFO, the constabularies, or perhaps the proposed new Economic Crime Agency, the need to combat financial crime should be added as an FCA operational objective.

(ii) Regulatory principles

The position of the industry in relation to principles has the capacity to undermine their intent and application.[6] Authority and clarity are needed through the making of rules. There is recognition in the FSA of the difficulties here:

> "I have previously said that I expect the FSA to move towards more detailed prescription...Effective enforcement and redress requires clarity of responsibilities and a process that can stand up to clear external scrutiny. It is thus inevitable that a conduct regime will lean more towards rules than principles as this is a necessary consequence of its focused objectives"[7]

Consumer responsibility

The principle of consumer responsibility needs to import the provisos associated with the reasonableness of this expectation contained in s 5 of the current FSMA and referred to in the consultation paper at 4.17, which take into account the differing degrees of risk, the level of experience and expertise that different consumers may have, the product they are buying, the channel through which they are buying it and the needs that consumers may have for advice and accurate information. It needs to be linked with an increase in accountability to consumers.

If it is suggested that consumers are given greater responsibility then this needs to be married with greater accountability to the consumer. In a market where some products are essential to functional daily life or future planning, and where competition is weak, direct accountability mechanisms for the consumer are poor. The regulator therefore plays an important role in working on the consumer (and industry's) behalf to ensure products are safe, fit for purpose and promote rather than inhibit competition by way of unnecessary complexity. Well targeted product intervention would increase the confidence of all classes of existing and prospective consumers in the products purchased. The US Consumer Protection Act recognises this through the setting of product standards. The Panel's research suggests that the great majority of people expect to take responsibility for their own actions, but that

[6] In particular see the BBA's judicial review action of the FSA's policy statement on PPI, lodged October 2010.
[7] Hector Sants, Speech to BBA conference on the Financial Conduct Authority, March 2011.

they also expect to be treated fairly, which means to them that their expectations are met.[8]

Duty of care

To balance the principle of consumer responsibility we support the inclusion of a principle that authorised firms have a duty of care to their clients, (in a similar way to the fiduciary duty established under the Dodd-Frank Act). The principle would not create new obligations but replicate the common law principle.

12. What are your views on the Government's proposed arrangements for governance and accountability of the FCA?

FSA has traditionally had strong market expertise and performed its markets role well, but could have done better in consumer protection. Throughout the FCA there is a need for consumer protection experience, expertise, resource and emphasis, but particularly at Board and Executive Director level.

We welcome a greater commitment to engaging more directly with consumers and in particular the proposal to "establish a robust and effective mechanism for understanding both consumer needs and preferences, and equally importantly, ensuring consumers feel that their views are both listened to and taken into account in the FCA's decision-making."[9]

The Consumer Panel forms an important sounding board at the early stages of policy development and decision making, providing a consumer oriented perspective before proposals are crystallised and subject to public lobbying. The endorsement of the Panel in the latest paper and by way of responses to the previous consultation supports our role in relation to conduct regulation.

The Panel is just one of the ways that the FCA should secure good information and advice and the appropriate input from those with relevant skills and experience. Clear and regular relationships with consumer advocacy groups, as well as a means of engaging with consumers more generally and with particular groups such as vulnerable or disadvantaged groups, will continue to be important. This engagement needs to be both structured and embedded throughout the sections of the new organisation.

It would improve decision making and provide more focus and accountability if the FCA were to commission specific consumer research and impact assessment to look at the health of the market, such as a regular consumer protection and well-being report along the lines of the annual Ofcom Consumer Experience report. In addition we support the proposal to better utilise existing sources of information such as the information from FOS and the requirement to consider and act and be seen to act, on issues the FOS brings to its attention,

[8] Opinion Leader for the Financial Services Consumer Panel, Consumer Perceptions of Fairness within Financial Services, June 2010

[9] Hector Sants, Speech to BBA conference on the Financial Conduct Authority, March 2011.

The CFEB will continue to contribute to the FCA's objectives through its financial capability work and the MOU between the organisations should be designed to ensure there is an obligation to exchange information and consult on issues that are likely to impact on consumer outcomes.

13. What are your views on the proposed new FCA product intervention power?

We welcome the intervention power in relation to products but for it to be effective it must be extended to include powers for temporary and permanent action in relation to mis-selling and unfairness issues. In extending these powers the regulator will be able to prevent situations such as the continued mis-selling of PPI over many years and the mounting consumer detriment that has resulted in the flood of complaints to FOS. It is the regulator's role to take preventative action rather than place the onus on individuals to challenge after detriment has occurred. The extension of the approach to wholesale markets is significant in providing better protection for pensions and savings.

We also support a broad range of intervention powers, including banning products, reviewing cost models, setting compliance standards, stress testing, periodic reviews of distribution and performance, and selective pre-approval of products. The provision for unenforceability of contracts in breach of the intervention rules is an important addition in providing protection for consumers during enforcement action. The intervention power also requires support through appropriate remedies applied by the regulator. The FCA must be willing to exercise the revised s.404 powers and restitution orders and should consider further whether additional collective redress mechanisms are necessary.

.14. The Government would welcome specific comments on:

- **the proposed approach to the FCA using transparency and disclosure as a regulatory tool;**
- **the proposed new power in relation to financial promotions; and**
- **the proposed new power in relation to warning notices.**

<u>Transparency and disclosure as a regulatory tool</u>

The inclusion of regulatory principles on transparency and making information available signals good intentions on behalf of the new regulator. We are concerned however that these principles are still subservient to s.348 and that, without amendments to s.348 or the making of rules under s.349 to support disclosure, the current cautious approach will persist. For example the regulatory principles will not provide the regulator with the authority to publish complaints data, which are currently published courtesy of a voluntary agreement between industry and the FSA. In order to support the regulatory principles we recommend that further consideration be given to the amendment of the definition of confidential information and to the making of rules specifically supporting the public interest in availability of information.

Reputational regulation is an extremely efficient and effective way of regulating provided that consumers have the information they need in good time and in an

appropriate form. Information itself is not useful unless it is relevant and contextualised. The US has long required companies to file detailed financial information as a matter of course through the Securities and Exchange Commission in order to provide all investors with access to certain basic facts about an investment prior to buying it, and so long as they hold it.

Just as regulatory failure reports may include the disclosure of information where this is justified in the public interest, it should be possible to disclose information in the course of investigations to support the regulator's objectives and principles where there is a clear public interest in avoiding detriment and enabling competition.

Financial promotions

We support the new power to direct firms to withdraw misleading financial promotions. The Panel recommends that the withdrawal power applies also in relation to unfair practices such as targeting vulnerable consumers or those for whom the product may be unsuitable. Those who repeatedly fail to comply with the financial promotions rules or commit serious breaches should be required to submit copy prior to advertising for approval by the FCA.[10]

Warning notices

We are also concerned as to the extent of information that will be provided if it is the intention only to publish that a warning notice has been issued and not the warning notice itself. For this to be an effective tool for consumers the publication needs to identify the firm, the reasons for the warning notice, the products or practices involved, and the time period being investigated. [11] We support the publication of the warning notice and relevant information.

15. Which, if any, of the additional new powers in relation to general competition law outlined above would be appropriate for the FCA? Are there any other powers the Government should consider?

We support both a market review power and a market investigation power for the FCA and consider that the regulator should have full concurrent powers as with other sector regulators including being able to prohibit cartels and abuse of dominance. The conduct regulator will in effect be performing a similar role in relation to what have now become utilities in both transactional services and pensions and savings.

The FCA will have an in depth understanding of the industry and should be able to conduct an investigation and form a view, try to seek a resolution and then ultimately

[10] The Advertising Standards Association committee of Advertising Practice Code may require persistent offenders to have some or all of their marketing communications vetted by the CAP Copy Advice team until the ASA and CAP are satisfied that future communications will comply with the Code.

[11] The Australian regulator, ASIC, issues infringement notices where they believe a firm has contravened the Act. Firms are given an opportunity to remedy the contravention though complying with the infringement notice requirements within 27 days of being notified. At the end of 27 days, whether there has been compliance or not, ASIC may publish the notice.

refer a matter to the Competition Commission. For example, the issues surrounding the emergence of packaged bank accounts would be dealt with quite differently by a financial services regulator with competition powers.

The super-complaint power is posed as an alternative to the market investigation reference power (MIR), when it serves a different purpose. An MIR power can be used by the regulator to secure a legally binding commitment; whilst a super-complaint power can be used by the Consumer Panel or other interested organisations to bring a matter to the attention of the regulator and/or the competition authorities. We therefore support the inclusion of both powers.

The Panel would benefit from access to the super-complaint power in that our power to require responses from the regulator is weak under the current s.11 of FSMA, and does not do enough to draw attention to issues that warrant further investigation. It is also important that an organisation with guaranteed resources is able to initiate super complaints where others might not have the flexibility to use or divert resources in this way. The Panel itself may require more resources in order to carry out this function effectively.

The extension of the super-complaint power to other qualified entities is also vital. The Panel is in a different position from consumer advocate organisations in that it is part of the regulatory system and maintains a relationship where early warnings and information are exchanged with the regulator in order to influence policy at the formation stage, rather than at the public lobbying stage. The super-complaint power needs to be widely available to consumer advocates and interest groups subject to the application provisions of the Enterprise Act. Consumer organisations represent different interests and the potential needs to be there to raise issues about anti-competitiveness and unfair practices that apply to all consumers or segments of consumers.

The super-complaint power under the Enterprise Act should be more broadly defined if it is to be applied effectively to financial services. The current definition of "consumer" excludes those carrying on a business.[12] In the present context, this definition would leave exposed those non-financial businesses that are not given protection by other relevant legislation, such as that for consumer credit, by competition policy, by redress mechanisms such as the Financial Ombudsman Service, or by conduct regulation.

In practice, all but the smallest non-financial enterprises are left unprotected. Moreover, such businesses are unlikely to be regarded by the FCA as part of its consumer protection mission. The resulting regulatory underlap is a matter of

[12] consumer" means any person who is—

(a) a person to whom goods are or are sought to be supplied (whether by way of sale or otherwise) in the course of a business carried on by the person supplying or seeking to supply them; or
(b)a person for whom services are or are sought to be supplied in the course of a business carried on by the person supplying or seeking to supply them;
and who does not receive or seek to receive the goods or services in the course of a business carried on by him;

considerable concern: it is well known that small and medium-sized enterprises (SMEs) and larger "mid-capitalisation" companies that seek external finance are heavily reliant on banks and other financial services.[13]

As a first step to address this underlap, the Panel proposes that the Enterprise Act definition of consumer be widened to include representatives of non-financial businesses for the purpose of submitting super-complaints about financial services.[14] This is particularly relevant if the consumer credit jurisdiction is transferred to the FCA.

Regulatory Processes and Co-ordination

17. **What are your views on the mechanisms and processes proposed to support effective coordination between the PRA and FCA?**

The split of supervision and conduct functions should be supported by strengthened communication and consistency. Achieving this will be a challenge for two bodies with different objectives. There needs to be oversight and regular monitoring to ensure that the duty to co-ordinate results in effective co-ordination. The Panel proposes that some of the necessary scrutiny of co-ordination and communication could be provided both through regular internal audit and also through the Special Supervisory Unit, an independent unit within the current FSA which reviews how supervisors are dealing with relationship managed institutions.

In addition, we propose the following mechanisms to achieve a more even balance between the PRA and FCA:

- Annual reporting by the Treasury Committee on how the FCA and PRA are co-ordinated.
- Bi-annual reports by the FCA to BIS and HMT, comparable to the bi-annual stability reports by the Governor of Bank of England.
- A relationship for the FCA Panels with the PRA and FPC, similar to that in s10&11 of the FSMA to strengthen the governance of both organisations.

The exchange of information from PRA to FCA will be paramount to FCA properly performing its functions. There is some concern that, because of the commitment to financial stability, prudential supervision will lose its focus on conduct issues and unfairness and that even if information is passed on to FCA, it will not be adequate. Incentive structures embedded in pay and performance reviews, are required to ensure the sharing of information.[15]

[13] " .. SMEs that do seek external finance are almost entirely reliant on banks, in the form of bank loans, overdrafts or other working capital products such as invoice discounting and factoring. …Mid-sized firms .. defined .. as having a turnover of £25 million to £500 million … tend to be largely reliant on banks for external finance". "Financing a Private Sector Recovery", Cm 7923, July 2010, HM Treasury and BIS, paragraphs 3.7, 3.11 and 3.12.

[14] This proposal is more encompassing than the proposal aired in "A competition regime for growth: a consultation on options for reform", BIS, March 2011.

[15] The Australian twin peaks model has separate prudential and conduct regulators in addition to the Central Bank who all have representation, along with the Treasury on an overarching Council of Financial Regulators.

In relation to dual regulated firms the process required if the FCA seeks to take action, issue directions, exercise OIVOP powers, or make rules is cumbersome and inhibits the flexibility and responsiveness of the FCA to take immediate action in relation to matters that may result in significant detriment to consumers. We propose that further consideration be given to streamlining the process.

18. What are your views on the Government's proposal that the PRA should be able to veto an FCA taking actions that would be likely to lead to the disorderly failure of a firm or wider financial instability?

The possibility of a PRA veto could act as a restraint on the FCA properly exercising its consumer protection functions and may therefore result in significant detriment to consumers. Financial firms may use the existence of the veto to game the system, seeking regulatory forbearance on exaggerated grounds of instability risks. We are not convinced that the proposed Parliamentary scrutiny would avert these potential deficiencies.

The PRA is able to intervene where it considers FCA actions are likely to lead to disorderly failure of a firm or firms, or wider financial instability. We accept the need for the PRA to have a veto in the case of disorderly failure, but question whether the PRA should be permitted to exercise its veto on grounds of "wider financial instability", a macro-prudential consideration which should be the FPC to decide.

The Panel proposes that if there is a role for a veto in circumstances where actions proposed by the FCA create a risk of wider financial instability, the decision to deploy the veto should be with the FPC rather than the PRA. The FPC has no direct relationship with the firms involved and, given its broader concerns, the FPC should be more able to balance competing issues. The FPC already has a role in providing advice and expertise to the regulators and in advising on disputes where matters could have material financial stability effects.

Ultimately if the PRA has to use its veto it is a strong indication that it has failed in supervision and the required interventions have not been made earlier. The veto should be seen as a last resort.

19. What are your views on the proposed models for the authorisation process – which do you prefer, and why?

The responsibility for the authorisation process is not straightforward and lack of clarity may cause problems or inconsistencies. We welcome the separate focus on conduct approval at the authorisation stage as previously there has been an exclusive focus on prudential issues.

23. What are your views on the Government's proposals on the treatment of mutual organisations in the new regulatory architecture?

The new regulatory regime will have a role in promoting competition, efficiency and choice. Barriers to competition and choice, for example through onerous authorisation requirements, market dominance, or monopolistic business models, make it difficult for others to compete except on the same terms and should be ongoing regulatory considerations. These will not be tackled solely through a requirement to consider mutuals in cost benefit analysis but should consider differential regulation according to achievement or otherwise of desired outcomes, particularly consumer outcomes.

The recognition of competition by the PRA should go further and include the proposition in the Coalition Agreement that the regulatory regime includes supporting different ownership models.

24. What are your views on the process and powers proposed for making and waiving rules?

We are concerned at the possibility of the PRA overruling the decisions of the FCA without sufficient checks and balances and refer to our response to question 18.

Compensation, dispute resolution and financial education

30. What are your views on the proposals relating to the FOS, particularly in relation to transparency?

The Financial Ombudsman Service (FOS) has played a vital role in the regulatory landscape since its inception. Whilst we are optimistic that consumer detriment and consumer protection will be better dealt with by a focused conduct regulator, one of the valuable functions that the FOS provides is redress to consumers in areas where regulators have been slow to act, for instance in relation to PPI, set off and issues around charges on current accounts. The FOS has recently been under extraordinary pressure as a result and needs to be supported in resources and adequate powers to effectively perform its role.

As has been acknowledged in this consultation, the FOS provides valuable information to identify risks in the system and amongst firms themselves and we support the information exchange with the regulator, a requirement for the FCA to have regard to the information it receives from the FOS, and the obligation to act on the information received where it reveals conduct issues.

The publication of determinations from the FOS provides a vital regulatory tool in order for consumers to exercise choice, regulators to identify risks and problems, and firms to undertake root cause analysis and reduce their costs in problem solving. The publication of complaints data also serves to support these goals and the FOS should be encouraged and enabled to publish more detailed breakdowns of its complaint

information and in particular benchmarked data on how individual financial services businesses handle complaints.[16]

31. What are your views on the proposed arrangements for strengthened accountability for the FSCS, FOS and CFEB?

The proposals for the publication of annual plans and for these bodies to be audited by the National Audit office are useful mechanisms providing that assessments of value for money take into account social outcomes. It needs to be recognised that developing appropriate outcome measures may take some time. The additional mechanisms should not be regarded or used as ways of decreasing the operational independence of these bodies.

European and International issues

32. **What are your views on the proposed arrangements for international coordination outlined above?**

We support the MOU between Treasury, BoE, PRA and FCA on overall international coordination within the UK's system for financial regulation in the hope that this will ensure issues of consumer protection and conduct risk are appropriately considered as part of the international supervisory process.

[16] As recommended by the report of Lord Hunt of Wirral , "*opening up, reaching out and aiming high – an agenda for accessibility and excellence in the Financial Ombudsman Service", April 2008*