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Financial Regulation Strategy
HM Treasury
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Dear Sirs

A new approach to financial regulation: draft secondary legislation

This is the Financial Services Consumer Panel's response to the draft secondary legislation to the Financial Services Bill.

The Panel welcomes the proposed changes to the Threshold Conditions (TCs), particularly the requirement for a firm's management to act with probity. However, we feel the TC should be further enhanced to protect the interests of consumers by requiring firms to treat their customers fairly. This should help the new Financial Conduct Authority (FCA) ensure the numerous mis-selling scandals which have plagued the financial services industry are not repeated under the new regulatory structure.

The Panel also feels the Government should undertake a fundamental review of the *registered* firm regime, rather than simply dividing responsibility for mutual societies between the Prudential Regulation Authority (PRA) and FCA. The Panel has witnessed over the past few years how this regime has confused consumers and led to detriment. The Panel believes essential protection standards should be available to all consumers, irrespective of whether their financial services provider is an *authorised* or *registered* institution.

The Panel feels effective compensation scheme arrangements are an essential consumer protection mechanism. Separating responsibility for the Financial Services Compensation Scheme (FSCS) between the new regulators is not ideal. Maintaining effective coordination between the PRA and FCA is therefore going to be crucial to ensure the FSCS is able to fulfil its function. We also urge the Government to ensure that, in the absence of a statutory duty, the PRA seeks input from consumer groups when fulfilling its responsibilities for the Compensation scheme arrangements for deposits and insurance schemes.

Q1. Do you have any comments on the draft Order?

The Panel recognises the need to retain flexibility to change the division of responsibilities between the PRA and FCA in response to market developments, changes in the economic environment or international initiatives. However, it is essential that the interests of consumers are considered fully if the Treasury makes a change to the Order. This is particularly important as the PRA has no statutory duty

to consider the effect of its actions on consumers or respond to representations from the Consumer Panel. If the PRA's responsibilities were expanded, so its actions could have a greater impact on consumers, there could be significant unintended consequences if new rules or requirements were implemented without consulting consumer representative groups.

The Panel has no specific comments on the current draft Order, which reflects our understanding of the intended division of regulatory responsibility between the PRA and FCA.

Q2. What are your views on the proposed division of threshold conditions between the PRA and FCA?

and

Q3. What are your views about the new content of the threshold conditions?

and

Q4. Do you have any other comments?

The Panel welcomes the proposed changes to the Threshold Conditions (TCs), particularly the requirement for a firm's management to act with probity. We hope this will help the new regulators address the inappropriate culture and incentive structures within banks as these have directly led to consumer detriment and undermined trust in the sector. This was evidenced by the widespread mis-selling of Payment Protection Insurance (PPI) and interest rate swaps, as well as the LIBOR scandal.

However, the Panel believes the revised TCs could, and should, be further enhanced to protect the interests of consumers. In particular, we believe the TCs should require firms to ensure they treat every customer fairly. This includes, but is not limited to, acting honestly, fairly and professionally in the best interests of their customers and managing any conflicts of interest. As well as setting a benchmark this will, we believe, serve as a key supervisory tool for the FCA to intervene where a firm is failing in its duty to its customers.

Q5. What are your views on the proposed threshold conditions?

and

Q6. Do you have any other comments?

The Panel has no additional comments beyond those made in response to Question 2, 3 and 4.

Q7. What are your views on the threshold conditions that should apply to EEA and Treaty firms?

and

Q8. What other comments do you have, if any, on any issues that should be considered with regards to this proposed approach?

The Panel considers it essential that the interests of all UK consumers are protected by financial services regulation irrespective of whether they trust a UK-based firm or firm operating in the UK from another country to look after their finances. We therefore agree it is appropriate for EEA and Treaty firms, undertaking business in

the UK, to meet TCs. The Panel feels the TCs set out in the consultation are appropriate but, as we outlined in our response to Questions 2, 3 and 4, we believe firms should also be required to ensure they treat their customers fairly.

Q9. What is your view on the high-level approach taken to splitting the functions between the PRA and the FCA?

and

Q10. What is your view on the approach taken to require and allow the FCA and the PRA to effectively co-ordinate their actions under mutuals legislation?

and

Q11. What other comments do you have, on principles or issues that you think should be considered with regards to the policy approach of the Order?

The Panel believes mutual societies play an important role in a competitive financial services market. We therefore welcome the Government's commitment to support the mutual sector. This has the potential to deliver significant consumer benefits, particularly in the retail banking market where we have long been concerned by the lack of effective competition.¹ However, we feel it is important that essential consumer protection standards are always maintained irrespective of the status of the firm a consumer has trusted to look after their finances.

The Panel firmly believes the Government should undertake a fundamental review of the protection afforded to customers of '*registered*' firms. In our experience, consumers are unclear, and cannot reasonably be expected to appreciate, that regulatory protection is significantly lower for customers of *registered* firms compared to '*authorised*' institutions.

Over the past few years, the Panel has witnessed various examples of the confusion and potential for consumer detriment created by the *registered* regime. In one of these, an FSA *registered* mutual society was promoting an attractive fixed-term savings bond, which offered a higher rate of return than available from other FSA *authorised* firms. The mutual society failed to make clear to its customers that deposits were not covered by the FSCS nor would they have the right of recourse to the Financial Ombudsman Service (FOS). The FSA eventually forced the firm to cancel all applications for the bond and pay refunds to all those who had invested. These actions prevented any consumer from suffering detriment, but the regulator's ability to take action was restricted by the limited enforcement powers available under the *registered* regime.

In another example, around 13,000 consumers suffered detriment and potentially lost capital placed with a money exchange firm when it went into administration. Despite holding client money, this firm was an FSA *registered* institution as money exchange is not an FSA-regulated activity. This meant its customers were not entitled to seek compensation from the FSCS. The currency exchange services offered by this firm consistently topped the best buy tables and allowed people to buy cash online up to a year in advance. According to the many media reports about the failure of this firm, many of its customers were unaware of the risks to their money.

¹ See the Financial Services Consumer Panel's Paper '*Better banking services and the myth of free banking: Towards a dynamic Personal Current Account market*' March 2012 - http://www.fs-cp.org.uk/publications/pdf/consumer_banking_position_paper.pdf

Rather than simply carrying over the *registration* regime and dividing responsibility between the new regulators, we believe the Government should undertake a fundamental review of the protection afforded to consumers of *registered* firms. As a minimum, FSCS and FOS protection should be afforded to all customers irrespective of the regulatory status of their financial services provider. We also feel there should be a review of the enforcement powers available to the PRA and FCA to address failures in *registered* firms.

Q12. What is your view on the proposal to apply the PRA's objectives to its mutuals functions?

The Panel agrees, for the reasons set out in the consultation, that it is appropriate for the PRA's objectives to apply to its function under mutual legislation. However, as we have outlined in our response to Questions 9, 10 and 11, we believe the Government should undertake a fundamental review of the *registered* firm regime.

Q13. What is your view on the proposal to not apply the FCA's objectives to its mutuals functions?

As we outlined in our response to Questions 9, 10 and 11, the Panel believes essential consumer protection standards should be maintained irrespective of whether a customer trusts an *authorised* or *registered* firm to look after their money. As such, we believe the Government should undertake a fundamental review of the *registered* firm regime and the FCA's objectives should be applied to its function under mutual legislation.

The Panel has no comments in response to Question 14 – 25.

Q26. Do you have any views on the draft Order at Annex E?

The Panel supports the provision, included in the Financial Services Bill, to empower the new regulators to take action in relation to a parent undertaking, which is itself not regulated, but controls and exerts influence over an authorised person. We consider this to be an important power to maintain consumer protection and take action to prevent detriment. Having reviewed the draft Order included in *Annex E*, we feel this is appropriate.

Q27. Do you have any views on the drafting of the FSCS Order at Annex F?

The Panel considers the FSCS to be an essential consumer protection mechanism. It is fundamentally important for consumers to have confidence that they are adequately protected in the event that their financial services provider fails.

The Panel has reviewed the draft Order included in *Annex F* and has no specific comments. However, we feel splitting responsibility for the FSCS between the PRA and FCA is not ideal. To ensure the FSCS has sufficient resources and powers to fulfil its functions, it is essential that there is effective coordination between the PRA and FCA.

The Panel is also concerned that the PRA will have responsibility for the compensation scheme arrangements for deposits and insurance schemes, yet is not required to consult or consider representations from consumer groups. To fulfil its

responsibility effectively, we hope the PRA will seek input from consumer groups such as the Panel. This will help ensure the arrangements continue to fully protect consumers' interests.

The Panel would also like to take this opportunity to highlight three important changes to the FSCS arrangements which we believe are needed to ensure they provide an appropriate degree of protection for consumers:

- Firstly, provide deposit protection cover by brand on a trading name basis rather than by 'FSA authorised institution'. We think it is unreasonable to expect customers to realise which firms form part of a wider company group. Cover per brand is more logical and sensible as this is how products are sold and the basis on which consumers buy them. This would also make for clearer statements about the level of consumer protection in the event of a future bank failure. Of course we recognise that this is currently being considered at an EU level.
- Secondly, the £85,000 deposit protection limit should be increased for consumers with temporary high balances to protect consumers who are, for example, in the process of purchasing a house.
- Finally, a consistent compensation limit should be applied across all Self-invested Personal Pensions (SIPPs). The current position, whereby the limit differs between insured and trust-based schemes creates an anomaly which must be addressed. We have urged the FSA to bring about consistency for all SIPPs and implement a compensation limit appropriate to the level of funds which a consumer could accumulate over their working life. The Panel believes it is wholly unfair for pension savers to be exposed to substantial losses, which could represent a lifetime's savings and could not be realistically recouped.

Q28. Do you have any comments on the Government's proposals for designating consumer bodies as super-complainants to the FCA, or on the text of the draft criteria and guidance at Annex G?

The Panel has always supported the requirement, set out in the Financial Services Bill, for the FCA to accept and respond to super-complaints from designated consumer bodies. We feel the criteria for organisations seeking super-complaint designated status are appropriate.

To ensure eligible organisations are easily able to apply for designated status, we encourage the Government to consider whether groups registered as super-complainant under the 2002 Enterprise Act could automatically be given FCA super-complaints powers – or at least only required to complete a shortened application process. Given the guidance included in *Annex G* is based on the existing BIS process, we feel this is an option worth exploring to help ensure appropriate consumer representative groups can gain FCA super-complaint powers without unnecessary difficulty.

Yours faithfully,

Adam Phillips
Panel Chair