Delivering consumer protection

Introduction

The FSA had a statutory objective to secure an appropriate degree of protection for UK consumers. It did this through the way that it authorised, supervised and enforced against regulated firms and approved individuals, and in how it responded to emerging risks and tackled sector or thematic issues. The FSA also used lessons learnt from behavioural economics to understand better how consumers make financial decisions and what impact this had on firms' behaviour and how it regulated them.

This chapter sets out how the FSA delivered on the *2012/13 Business Plan* aims, set out as:

- Supervisory initiatives, including development of the supervisory approach, product intervention, Retail Distribution Review (RDR) implementation and Mortgage Market Review (MMR) implementation

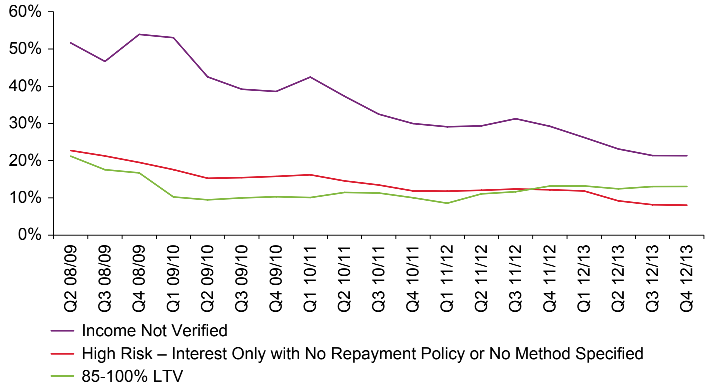
- Domestic policy initiatives, including work on redress, engagement with the banning of referral fees and the with-profits review

- International policy initiatives, including work on Packaged Retail Investment Products (PRIPs), Undertakings for Collective Investment in Transferable Securities Directive (UCITS), Alternative Investment Fund Managers Directive (AIFMD) and compensation and dispute resolution directives.

Key metrics

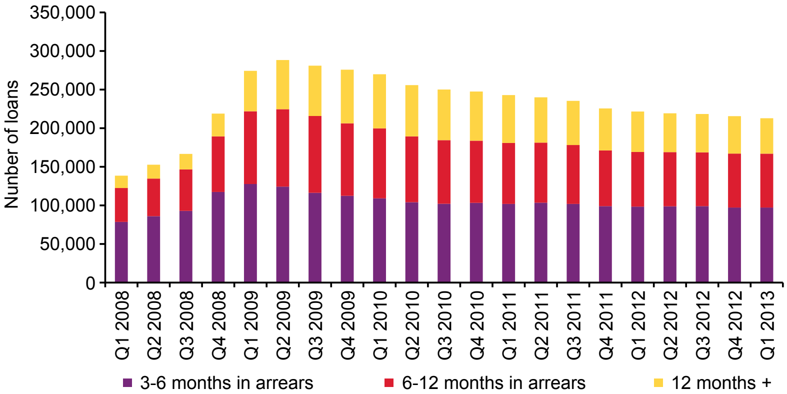
The FSA used a wide range of metrics to assess and measure its work. These included:

Chart 1: Higher risk mortgage indicators



Overall, during 2012, the FSA saw a continued reduction in unverified-income market share and an increase in less risky repayment methods. There were small fluctuations across LTV banding, with mortgages with LTV of 90%+ stabilising at around 2.2% and LTVs of 85% to 90% at around 11%. These trends may be due to the prolonged financial crisis and the associated reductions and uncertainty in real incomes, and/or to lenders' attempts to preserve income margins through reducing risk.

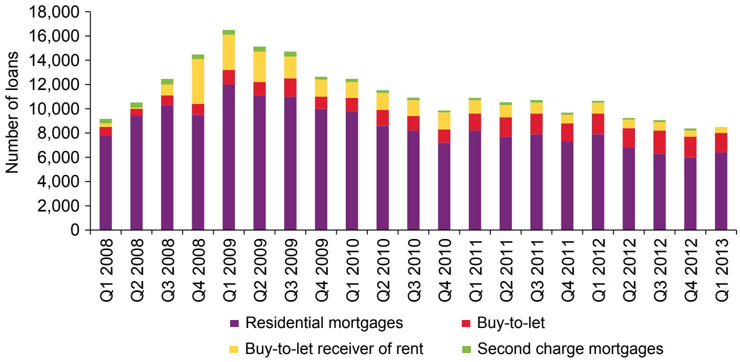
Chart 2: Number of mortgages in arrears by length of arrears



Source: CML

Arrears over three months have continued to fall over the last year, down to 1.91% (Source CML) of total outstanding mortgage loans at the end of 2012, the lowest rate since Q4 2008. Residential long-term arrears have flattened off since the beginning of last year and repossessions have been falling steadily. The number of second charge repossessions has seen some increase over the last few quarters and is back up to levels seen at the end of 2011.

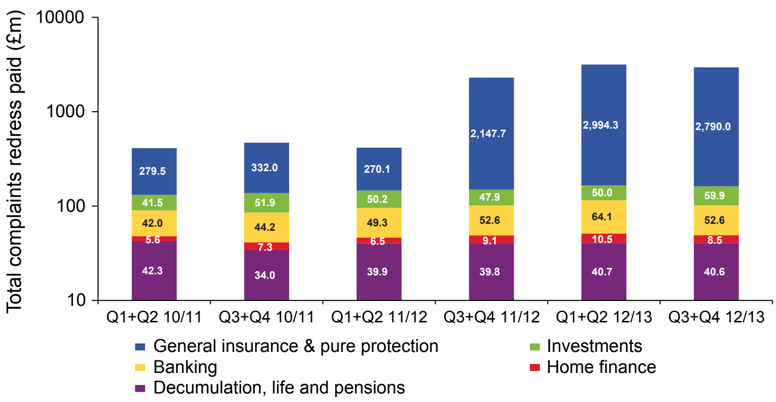
Chart 3: Number of mortgages in arrears



Source: CML, FLA

CML and FLA figures show that repossessions for 2012 were down to 37,328, their lowest level since 2007. The number of voluntary repossessions continued to rise to now accounting for 30% of total repossessions. CML data indicates widespread forbearance with declining repossessions as a percent of mortgages in serious arrears (over six months). The fall in repossessions as a percent of arrears over six months is well below the peak seen prior to FSA intervention and the fall in interest rates in early 2009. The current repossession rate has changed little since 2011 and is comparable with the rate of forbearance seen after the 1990s housing crash.

Chart 4: Redress paid by firms

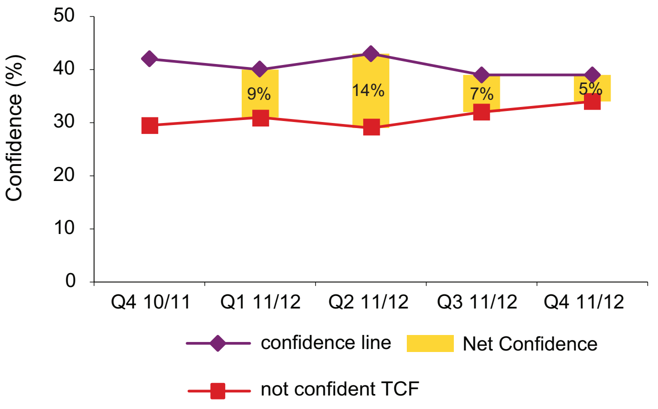


The above chart shows the amount of redress reported in the complaints returns up to the end of the FSA's financial year and split by firm type.

The amount of redress in Q3 and Q4 12/13 was 7.4% down on the previous period (2012 Q2 and Q3) but 29.1% up on the same period last year. Redress paid for decumulation life and pension products fell by 27.8% on 2012 Q2 and Q3 and banking products' redress decreased by 19.7%. Redress for home finance products increased by 3.9% and investments by 23.2%.

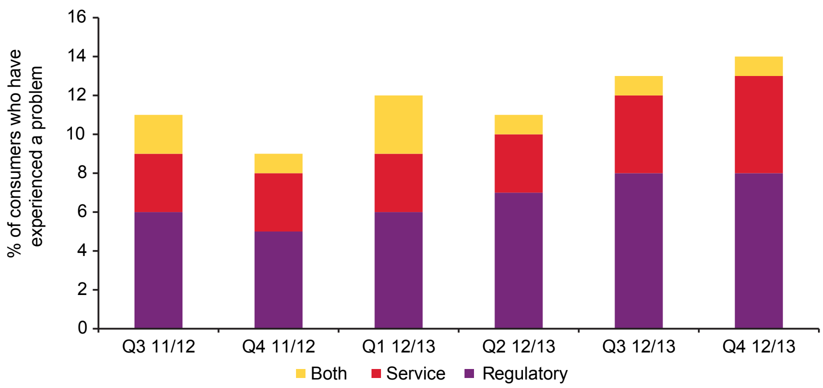
Redress for GI and pure protection products (which includes redress for PPI) accounts for just under 95% of the total amount of redress in the latest period compared to around 51% at the start of the series in 2009 Q3 and Q4. Although GI and pure protection redress was 30.5% up on the same period last year, it fell by 7.7% on 2012 Q2 and Q3.

Chart 5: Percentage of respondents to the Consumer Awareness Survey (CAS) who are confident firms are treating their customers fairly



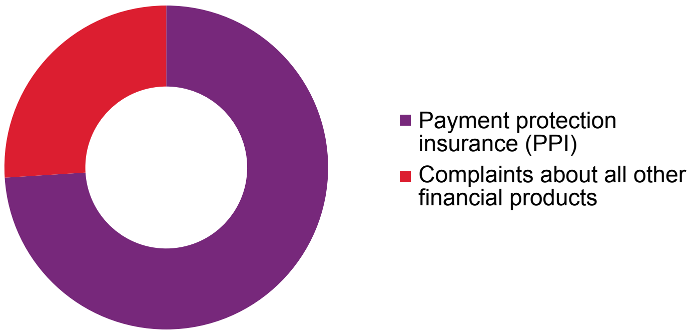
This FSA research, which takes a snapshot of consumer attitudes to how firms are treating them, shows that consumer confidence suffered a large fall towards the end of the FSA's financial year, in contrast to expectations earlier on in the year that firms were treating customers more fairly. There is a net fall between the last two quarters. This is mainly driven by the fall in the confidence in banks – with 25% of consumers reporting little confidence in banks – up from 20% in December. There are smaller falls in confidence in insurance providers and financial advisers.

Chart 6: Percentage of respondents to CAS who experienced any problems with a financial firm in the last 12 months



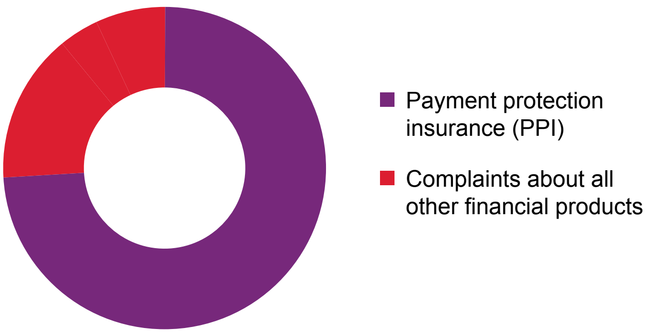
The number and type of problems faced by consumers rose slightly over the year. The most commonly reported problems related to conduct/service issues (9% in the final quarter of the FSA's Financial Year) such as rude or unhelpful staff and problems getting through to people on the phone. There was an increase in those reporting long queues in branches but a fall in reports of complaint handling and problems relating to bank charges.

Chart 7: Complaints made to Financial Ombudsman Service



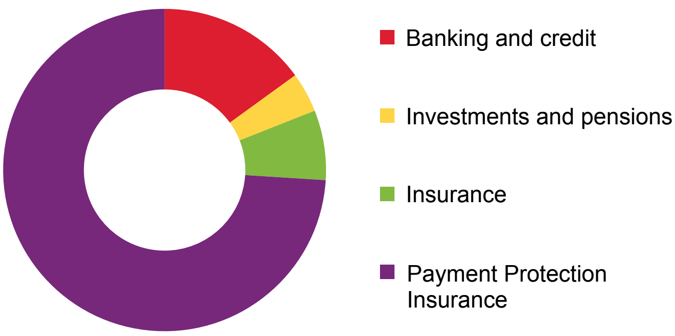
Source: © Financial Ombudsman Service Annual Review 2013

Chart 8: New cases reported to the Financial Ombudsman Service the by financial product



Source: © Financial Ombudsman Service Annual Review 2013

Chart 9: New cases reported to the Financial Ombudsman Service by area of complaint 2013



Source: © Financial Ombudsman Service Annual Review 2013

Over the last year, the Ombudsman Service handled 2,161,439 initial enquiries and complaints from consumers – over 7,000 each working day. Around one in four of the initial consumer enquiries they received turned into a formal dispute – a record 508,881 new cases, up 92% on the previous year.

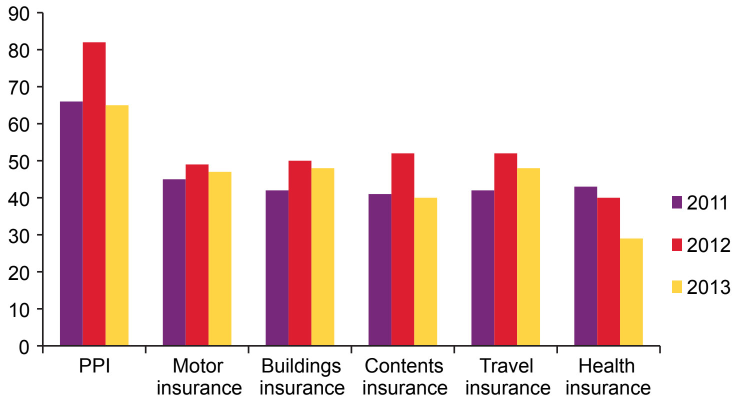
74% of new cases were about the sale of payment protection insurance (PPI), with the number of PPI complaints rising 140% to 378,699.

Investment-related complaints increased by 33%, while banking disputes and complaints about insurance other than PPI rose by 20% – resulting in the highest ever numbers of these cases.

62% of the total number of cases dealt with related to four banking groups – while 4,819 businesses accounted for just 3% of the Ombudsman Service's caseload.

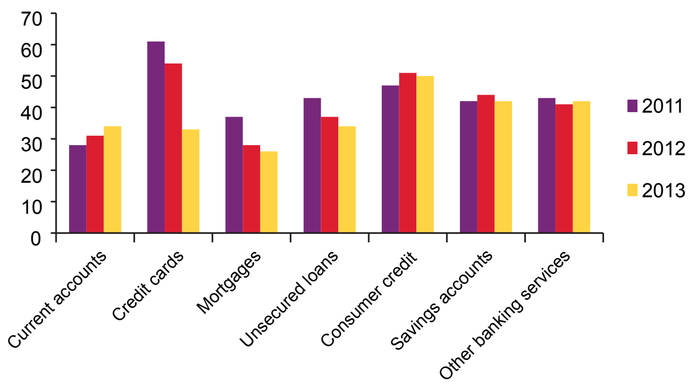
Chart 10: % of cases upheld by the Financial Ombudsman Service

Insurance complaints



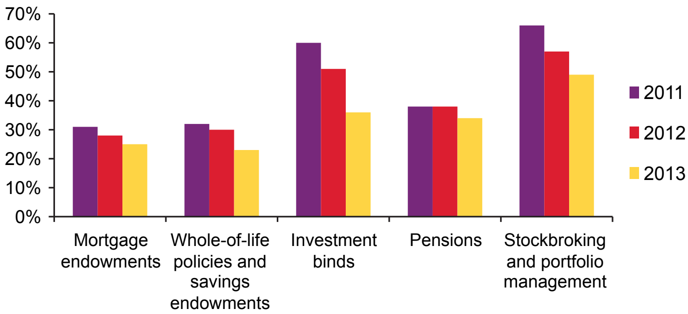
Source: © Financial Ombudsman Service Annual Review 2013

Banking and credit complaints



Source: © Financial Ombudsman Service Annual Review 2013

Investment and pensions complaints



Source: © Financial Ombudsman Service Annual Review 2013

In total the Ombudsman Service upheld 49% of the consumer complaints which they settled in the financial year 2012/2013.

This figure varied across complaints involving different financial products. For example, during the year the ombudsman service upheld:

- 65% of PPI cases – where some financial businesses are still not following the well-established approach to handling complaints and putting things right.
- 25% of complaints about mortgage endowments – where teh Ombudsman found that most consumers had been warned in the mid 2000s about a possible shortfall and had left it too late to complain.

The proportion of cases which the Ombudsman upheld in favour of the consumer varies substantially from business to business – between 3% and 100%.

Supervisory initiatives

Developing a supervisory approach

In 2012/13, the FSA developed and started to implement its new approach to conduct supervision. The model is designed to support a judgement-based and pre-emptive approach that is focused on delivering consumer protection.

The model is built around three clear pillars: Proactive Firm Supervision (Pillar 1) – assessing whether firms are run in a way that results in the fair treatment of customers; Event Supervision (Pillar 2), which addresses significant crystallising or crystallised conduct risks at the firm level; and Issues Based Supervision (Pillar 3), which addresses specific conduct risks at a product or sector level. The FSA also developed an approach to prudential supervision for those firms that will be solely regulated by the FCA.

Supporting the model is the development of a new approach to firm classification for conduct supervision, to ensure that a differentiated supervision process that is proportionate to the potential impact of the firm can be applied. A firm's classification drives the intensity of supervision. Firms were informed of the new classifications and what this means for them in March 2013.

BMSA is central to the proactive firm assessment (Pillar 1) with its purpose of identifying the key conduct risks that come from a firm's business model and strategy. In the last year the FSA completed a number of bespoke business model analyses, starting with the largest banking groups, with the output used to shape its firm supervision strategies and work programmes. For other larger firms the FSA developed a peer group approach to business model analysis across different sectors. These peer group analyses have been used to identify outliers and take action where significant issues were found.

A key aspect of proactive firm supervision are 'deep dives', designed to support the overall assessment of the extent to which firms embed fair treatment of customers. The 'deep dives' cover key areas of a firm's operation, including governance and the product life cycle from design through to post-transaction handling, allowing us to focus on the root causes of problems. A number of these deep dives have been completed to date. Where the work found issues these were tackled promptly.

Enforcement action

To support the increased focus on issues and products work across firms and sectors the FSA made enhancements to its approach. This includes ensuring this work is clearly driven by sector risk assessments based on its analysis of what is currently and prospectively driving poor outcomes for consumers. The FSA delivered key pieces of thematic work through the implementation of this enhanced approach. In 2012/13, it imposed 51 fines, totalling £423m, 11 public censures and 42 prohibitions.

Supervision's strategy has been supported by taking enforcement action where it is believed that firms and approved persons fail to comply with regulatory requirements, including where:

- firms fail to treat their customers fairly;
- customers have been mis-sold financial products; or
- firms have failed to implement systems and controls to mitigate risks to customers.

For example, some cases where enforcement action was concluded this year were:

- The FSA censured Black and White Group Limited (Black and White), fined the former CEO and Chairman and banned the former Chairman and COO for failings in relation to the sale of mortgages and payment protection insurance (PPI) following a Tribunal decision which concluded that Black and White failed to treat its customers fairly by encouraging staff to focus on sales rather than considering whether the products were suitable for customers.
- The FSA published Decision Notices relating to Arch Financial Products (AFP), Robin Farrell, AFP's Chief Executive and Robert Addison, a senior partner and compliance officer at AFP, for failing to manage conflicts of interest and exposing investors to the risk that the funds would not be able to liquidate their investments to meet redemption requests. The matter has been referred to the Upper Tribunal, which will determine the appropriate action for the FCA to take.
- Bank of Scotland was fined £4.2m for failures in its systems that meant that it held inaccurate mortgage records for 250,000 Halifax customers for considerable periods of time. This resulted in customers not receiving important information about changes to the terms and conditions of their mortgages. Bank of Scotland put in place a programme to rectify the fact that some customers had received potentially confusing information about changes to their standard variable rate mortgage contracts. While monitoring a consumer forum website, the FSA found a number of customers complaining that they had been wrongly excluded from the programme. In total, approximately 160,000 customers who were due good will payments totalling approximately £162m were excluded.

- The FSA took action against Peter Cummings, former Executive Director of HBOS plc, and Chief Executive of its Corporate Division. It imposed a penalty of £500,000 and banned him from holding any senior position in a UK bank, building society, investment or insurance firm for failing to exercise due skill, care and diligence by pursuing an aggressive expansion strategy within the Corporate Division without suitable controls to mitigate the risk and for failing to take reasonable care to ensure that the Corporate Division adequately and prudently managed high value transactions that showed signs of stress.

Retail banking

The FSA continued the transition to a more forward-looking, judgement based conduct supervision model for retail banks and building societies.

Within the retail banking supervision area the FSA rolled out an approach to analysing firms' business models and strategies to understand whether these business models are sustainable and to identify future conduct risks to customers. A number of bespoke analyses for the largest banking groups were completed. For medium-sized banks and building societies a peer group approach was used to identify firms with 'outlier' business models. Examples of the types of concerns identified through this analysis included profitability in key areas of a firm's business being dependent on very ambitious growth or cross-selling, predictions of aggressive cost cutting and products being developed without clear target markets, clear features or pricing. The FSA challenged firms on the potential for significant risks to customers as a result of these strategies and took action where it found issues or to prevent problems getting worse.

The FSA invested considerable supervisory time in challenging banks' senior management on their approach to understand the 'tone from the top'. In addition to the more traditional focus on systems and controls, it also considered how culture is embedded within the retail banks. Weaknesses in firms' governance and controls around conduct risks and a lack of consideration of the impact of issues on retail customers continued to be consistent themes in the retail banking sector.

For the largest groups, the FSA completed 'deep dive' assessments in key areas of retail banks' business such as governance, product design, sales and post-sales. This allowed supervisors to understand whether fair treatment of customers was being embedded in the way banks run their business. Where the assessment work found issues these were tackled to prevent problems getting worse and also focused on understanding and fixing the root causes of the problems.

It has been very encouraging to hear firms talking positively about the importance of managing their conduct risks and engaging with the need for cultural change. Overall, however, it is not yet clear that firms in the retail banking area can demonstrate they are consistently putting their customers' interests at the heart of their business.

In addition to supervisory work with individual firms the FSA delivered thematic and mitigation work on key issues that related to a number of firms in the retail banking sector. These projects are described in more detail later in the report and included continuing work on payment protection insurance, review of the sale of interest rate hedging products, mystery shopping on quality of investment advice, review of wealth management services offered by retail banks, and mitigation of risks on core banking and payments services.

Smaller firms

The FSA continued to deliver its four year rolling assessment programme for small firms, completing four out of the total of 12 regions. The programme includes workshops and proactive regulatory reviews with firms. The FSA completed the development of the online review tool – which the FCA will use to assess the lowest risk firms. It conducted two pilots of the online tool with firms during the year and full roll out will progress during 2013/14.

Enforcement action in small firms

In 2012/13, the FSA took 39 actions against small firms and their senior managers. It took action against 25 individuals, banning 23 and fined them a total of £1.32m. It also fined nine firms a total of £1.67m and in four cases it cancelled firm's permissions and censured one firm.

One of the FSA's priorities for 2012/13 was investigating the mis-selling of investment products such as Unregulated Collective Investment Schemes (UCIS) and the mis-use of self-invested pension plans. For example, in October the FSA fined Martin Rigney of Topps Rogers £117,330 and banned him from the financial services industry for mis-sales of UCIS. The FSA further broadened its approach with action against:

- a credit union and its CEO (the Pentecostal Credit Union and Reverend Carmel Jones) for diverting funds to other church organisations rather than lending to members;
- the mortgage lender Cheshire Mortgages Corporation, which was fined £1.2m and took action against its directors: and
- Gracechurch Investments, a stockbroking firm, and its directors for pressure selling.

Threshold conditions

A number of firms do not meet the basic standards needed to carry out the activities for which they have obtained authorisation – the so-called "threshold conditions". There was a team dedicated to taking action against these firms. In the last year, 36 firms have had their permission to conduct regulated business cancelled, and a further 162 firms took remedial steps to address breaches of the threshold conditions following action from this team. Similarly, the team took action against payments services firms, 19 of which have had their registrations cancelled for basic failings, and a further 60 firms have remedied breaches of the minimum standards. Recurring breaches related to lack of adequate resources (including Professional Indemnity Insurance and financial resources) and failures to comply with Ombudsman awards, non-co-operation with the authority, and non-submission of regulatory returns and non-payment of fees.

RDR implementation

The RDR came into force on 31 December 2012, one of the main requirements of which is that advisers can no longer receive commission from providers for advice and must meet new professionalism standards, including completion of higher qualifications. In the period up to implementation, the FSA provided support and, where necessary, greater clarity for the industry (including a number of industry newsletters) and monitored firm and adviser readiness. This ensured that firms were ready for the significant change brought about by the implementation of the RDR. The FSA also engaged with trade bodies and consumer groups before the implementation date to help them prepare for the change.

A number of waiver applications were received in relation to the new qualifications requirement, and over 100 applications were granted where there have been exceptional circumstances that have prevented the completion of qualifications. 47 applications were withdrawn and ten have been rejected. The FSA also published a factsheet to inform consumers directly of the changes.

Now that the rules are in force, thematic work is being carried out by the FCA to monitor compliance with the rules and check how firms have incorporated them in their business models.

The FSA successfully implemented a comprehensive set of processes, tools and systems to enable it to supervise compliance by the industry with the RDR rules. Some of the key outputs include:

- changes to the FSA's internal business processes allowing it pro-actively to identify potential rule breaches;
- changes to the FSA's strategic IS systems to capture and analyse the additional regulatory data submitted by firms;
- development of business operated solutions to assist with data capture and analysis; and
- design of a supervision strategy that will help measure compliance with the RDR rules and proactively manage market risks.

MMR and other mortgage work

The final package of MMR reforms was published on 25 October 2012, and will come into effect on 26 April 2014. One exception to this was the introduction of a new provision designed to prevent the unfair treatment of those borrowers who find themselves 'trapped' with their current lender, which came into immediate effect.

The FSA started its implementation programme, working closely with industry to ensure the new MMR regime is in place at implementation. It completed a series of intermediary and lender roadshows and meetings between January and March, and continued to track firms' readiness.

The MMR and its implementation took priority over the planned reviews of the regulatory approach to Third Party Administrators and of charging practices in the mortgage market.

At an EU level, the Mortgage Credit Directive has remained under discussion throughout the year. The FSA continued to support the Government in these negotiations.

Product intervention

In 2012/13 the FSA continued its work developing the product intervention strategy.

The new provisions setting out specific product intervention powers for the FCA are a key, high profile part of the Financial Services Act 2012, and the FSA supported the development of these provisions through the legislative process. As part of the preparatory work for the FCA, the FSA issued a consultation paper on the FSA's Statement of Policy on making temporary product intervention rules (as required by the 2012 Act). The FSA considered that the ability to make these rules will be an important part of the FCA's toolkit, enabling it to intervene earlier to protect consumers. By publishing the Consultation Paper, the FSA provided industry and consumer organisations with the opportunity to offer their views and feed into the policymaking in this area, and for the FSA to provide some clarity around the circumstances in which temporary rules might be used.

The FSA also advanced its thinking on developing a product governance framework, and tested ideas for a new product governance regime. These ideas are in development and the FCA will continue to work on this project in 2013.

The FSA also actively supported the introduction of an EU approach to product governance and product intervention. In particular, it was active in discussions that provided for a product intervention framework in the MiFID and MiFIR. The FSA was also supportive of the EU Parliament's proposals for product governance measures in the revised MiFID.

Financial promotions

Over the last year the FSA reviewed 7,345 financial promotions for compliance with its rules. Of those that were in breach, it took forward the medium high and high risk cases. This resulted in 199 financial promotions being amended or withdrawn.

Engaging with firms and consumers on banking/payments issues

The FSA remained focused on ensuring that customers are getting fair outcomes from firms in relation to the delivery of core banking and payment services. The FSA acted where firms have failed to meet the requirements of the banking conduct regime, including:

- Working successfully with the largest banks and building societies to ensure that where customers' payments are rejected during overnight processing due to insufficient funds, they are re-tried later in the day. It is estimated that this change will remove approximately £200m lost each year to consumers through unpaid item fees as they can now pay in funds on the day to meet the payments and avoid these charges.

- Changing the behaviour of the largest debit card providers to ensure that they act on all requests from customers to cancel future dated payments (including recurring transactions/Continuous Payment Authorities). The FSA reviewed debit card providers' approaches with a particular focus on the problem area of payments due to pay day lenders. It worked closely with Citizens' Advice to understand and tackle the problems their customers have experienced.

- Undertaking follow-up testing to ensure consumers are benefitting from the increased speed and efficiency of payments; ensuring payments reach their destination by the end of the next working day after the payment was made; and, that when receiving funds into their accounts, consumers are given immediate access to those funds.

- Continuing to review whether firms are meeting their obligations to immediately refund unauthorised, fraudulent transactions on customers' accounts and taking action where necessary.

- Taking action where individual firms have not met the standard time of 15 days for transferring cash ISAs.

- Carrying out an initial review of the rapidly developing market for mobile banking and payments in order to understand the risks that these services pose for customers and to tackle potential concerns at the point where firms enter the market or develop their mobile banking/payments services.

Mystery shopping investment advice on retail banks

The FSA carried out a mystery shopping exercise looking into the quality of banks and building societies' investment advice. It used mystery shopping to gather first-hand evidence of what someone looking for investment advice from a bank or building society might experience. The results show that, while approximately three-quarters of customers received good advice, there were concerns with the quality of advice in the other quarter. In response the firms involved cooperated and agreed to take immediate action. This includes retraining advisers, making substantial changes to their advice processes and controls for new business, and undertaking past business reviews to identify historic poor advice and put this right for customers. Firms were also required to employ an independent third party to either carry out or oversee this work. One firm was referred to Enforcement.

Critical infrastructure

In response to the IT failures at RBS[6] that affected the bank's customers in June and July 2012, the FSA commissioned a review under Section 166 of FSMA into the causes of the failure. More broadly it required the chairmen of all the large UK retail banks to review the resilience of their own systems and mitigation plans and to ensure that critical IT infrastructure is adequately considered at board level.

Financial incentives

In 2012/13 the FSA completed its thematic work on financial incentives, published the findings and consulted on draft guidance, which was generally very positively received. It was found that most incentive schemes were likely to drive mis-selling and firms had not been dealing with this properly.

Final guidance was issued in January 2013, when the FSA also confirmed a wider review commencing in Q2 2013 to assess how firms have responded to the guidance and whether they are now managing the risks.

Asset managers – conflicts of interest

The FSA conducted thematic reviews of asset management firms, assessing their arrangements for managing conflicts of interest. Though there were some examples of good practice, it identified that many firms had failed to establish an adequate framework for identifying and managing conflicts of interests. It also identified breaches of the detailed rules governing the use of customers' commissions and the fair allocation of trades between customers. The FSA concluded that most of the firms visited could not demonstrate that customers avoid inappropriate costs and have fair access to all suitable investment opportunities. A Dear CEO letter titled *Conflicts of interest between asset managers and their customers: Identifying and mitigating the risks* was published in November 2012 setting out the findings and expectation. The FSA requested that the CEOs of the largest asset management groups attest by 28 February 2013 that their firms comply with FSA rules on the management of conflicts.

6 RBS (The Royal Bank of Scotland Plc), Natwest (National Westminster Plc) and Ulster Bank (Ulster Bank Limited (for Northern Ireland) and Ulster Bank Ireland Limited (for the Republic of Ireland).

Enforcement action – conflicts of interest

In May 2012, the FSA fined Martin Currie Investment Management Limited and Martin Currie Inc. (Martin Currie) £3.5m for failing to manage a conflict of interest between two of its clients. Martin Currie caused one client to enter into an ill-advised transaction that rescued another client from serious liquidity concerns and failed to disclose this conflict to its clients.

Wealth management

The FSA's previous work in this sector resulted in the sending of a letter in 2011 to the chief executives of wealth management firms outlining concerns. It had been found that 79% of the investment portfolios that were reviewed either had a high risk of being unsuitable or the FSA was unable to determine the suitability from the information that the firms held. This year, the FSA followed up that work by looking at the quality of the wealth management service offered by six large banks. The work focused on assessing the suitability of the investment portfolios that the banks created for their customers. It also looked at how the banks ensure that their customers receive the correct investments for their circumstances. The FSA completed the investigation stage of its work and told the banks its findings, which varied significantly across the banks assessed. The banks have cooperated and have agreed to undertake actions to improve the wealth management service for their customers.

Savoy Investment Management Limited and UBS AG – enforcement action

In November 2012, the FSA fined Savoy Investment Management Limited (Savoy) £412,000 for failing to take reasonable care to ensure the suitability of the investment portfolios of its wealth management clients. Savoy allowed its investment managers a high degree of discretion to advise its wealth management clients on their investment portfolios and had limited controls to ensure the suitability of its advice and portfolio management. A review of a sample of files found that 23% showed a high risk of unsuitability.

In February 2013 the FSA fined UBS AG £9.45m for failures in its sale of the AIG Life Premier Access Bond, Enhanced Variable Rate Fund (the Fund). UBS sold the Fund to 1,998 customers, with initial investments totalling approximately £3.5 billion. These failures led to UBS customers being exposed to an unacceptable risk of an unsuitable sale of the Fund. In particular, UBS failed to carry out adequate due diligence on the Fund before selling it to customers so UBS had an inadequate understanding of the nature of the Fund's assets and the consequent risks. UBS also failed to deal properly with complaints from customers about sales of the Fund.

Low value general insurance

Mitigating customer detriment arising from the design and sale of General Insurance products of potentially limited value was a supervisory priority in 2012/13.

The FSA used its full supervisory and enforcement toolkits to identify poor consumer outcomes. The FSA took robust action against a number of firms for failures in their products, sales and post-sales handling.

Its intervention has led some firms to:

- cease selling certain products;
- change products to remove misleading features;
- amend sales scripts; and

- deliver additional staff training.

The FSA worked to deliver redress for customers where products have been mis-sold. It has also used its powers under Section 166 of FSMA to identify the root causes of unfair sales practices in individual firms and then taken action to mitigate current and future customer detriment.

Card Protection Plan (CPP) Limited – enforcement action

In November 2012, the FSA imposed its joint largest ever retail fine of £10.5m on CPP for mis-selling its insurance products.

The FSA found widespread mis-selling of CPP's two main UK products, card protection and identity protection insurance. CPP sold its card protection product by emphasising that customers would benefit from up to £100,000 worth of cover for fraudulent transactions on lost or stolen debit and credit cards. However, this cover was not needed because customers were already covered by their banks. CPP also overstated the risks and consequences of identity theft during its sales of identity protection. Overall, the FSA found that, while CPP's products were relatively inexpensive, they were mis-sold widely and CPP encouraged its sales agents to be overly persistent. This case highlighted concerns about low cost insurance that offers little or no value to the customer.

Motor Legal Expense Insurance (MLEI)

The FSA conducted thematic work into MLEI. MLEI is the most common 'add-on' to motor policies, typically sold at £25 to £30. The FSA's consumer research showed that, though people have high awareness of the product, they have very little understanding of it. A thematic project concluded that the product is useful in packaging together the legal services to enable consumers to pursue their legal rights to recover their uninsured losses following a motor accident for which they were not at fault. However, the explanation of the product needs to improve at all stages in the sales journey – from comparison websites to policy wordings.

In line with the FCA's stated intention of taking regulatory action quickly the FSA provided early feedback, both to individual firms and to senior industry figures at a seminar on 19 February 2013. This new approach was welcomed by firms and has yielded good results. All the firms that took part in the project have agreed to amend their business practices as required. Either as a result of feedback to the FSA or their own internal reviews four major insurers are stopping 'opt-out' selling of MLEI and other add-ons. The FCA will review industry practices again in a year.

Domestic policy initiatives

Platforms

Following a comprehensive programme of research, which included consumer research (among those who use platforms), business model analysis of platform service providers and competition analysis, the FSA published CP 12/12 in June 2012. This proposed that platform service providers (in both the advised and the non-advised markets) should be remunerated only by a platform charge paid by the consumer. The FSA engaged extensively with the industry and received 80 responses to the consultation. The FCA published PS 13/1 on 26 April which confirmed the final rules.

With-profits review

The rule changes introduced in Policy Statement 12/4 intended to improve the governance of with-profits funds and tightened further some of the discretions exercised by companies and others that provide with-profits funds. The FSA also launched a consultation at the end of 2012 on with-profits mutuals so they can present a case for continuing to write new insurance policies without having to go into run-off, subject to their demonstrating fairness to policyholders and policyholder protection through sufficient security of policyholder benefits. This work will continue, with an FCA Policy Statement expected later on in the year.

On 18 October 2012, the FSA fined Sun Life Assurance Company of Canada (UK) Limited £600,000 for failing to establish and maintain adequate governance arrangements for its with-profits business during 2008 and 2009. These failings included Sun Life executing two significant derivative transactions without adequate review and approval from Sun Life's with-profits committee and its board of directors.

Referral fees

From 1 April 2013 the payment and receipt of referral fees in England and Wales was banned. The ban has been implemented by the Legal Aid, Sentencing and Punishment of Offenders Act 2012.

Before this there was an extensive firm-facing communications plan and a 'one minute guide' was prepared. These provided the industry with a high-level insight into the FCA's supervisory approach and interpretation of the ban, including reference to the FSA's coordination with other regulators.

Financial Services Compensation Scheme (FSCS)

During 2012, the FSA completed an in-depth review of a representative sample of firms to assess whether deposit takers have the systems in place to provide data to the FSCS so that it can pay most depositors within seven days of their bank, building society or credit union failing.

In May 2012 the FSA issued requirements on firms to improve consumer awareness of FSCS cover for deposits, following which it required deposit takers to display prominently stickers and posters in branches and on websites (in electronic form) explaining the compensation arrangements.

It also made rule changes to help the FSCS when the value of a claimant's investment is uncertain. The FSA gave the FSCS some additional flexibility in appropriate circumstances to pay full compensation where, under present rules, consumers would have to wait an excessively long time to receive full compensation.

The FSA also continued to work closely with the FSCS and the Financial Ombudsman Service in the area of consumer protection, including timely exchange of information in relation to breaches of its requirements, industry trends and financial failures (at risk and crystallised); and, where appropriate, it shares the intelligence and insights gained through its supervisory work.

FSCS funding

In July 2012 the FSA published CP12/16, setting out proposals for a review of the FSCS's funding arrangements. A well-funded and sustainable compensation scheme is important for financial stability and consumer confidence, and all financial services firms benefit from this.

The objective in formulating the new funding model was to establish a credible funding approach for the FSCS, one that balances the need for adequate funds with affordability for those contributing. Consultation Paper 12/16: FSCS Funding Model Review set out:

- proposals for change; and
- an explanation for those areas where it was proposed to retain the current approach.

The FSA confirmed final rules in January 2013 (FSA CP13/1), except the rules on funding the FCA retail pool, for which it issued a further short consultation and subsequently confirmed the final rules in March (FSA PS13/4).

The key new features of the model include:

- Revised annual thresholds based on assessments of affordability.
- A retail pool that would be triggered if one or more FCA classes reached their annual threshold (i.e. the limit that funding class would be expected to contribute in any one year).
- Where the retail pool is triggered by costs arising from the FCA FSCS intermediation funding classes, all FCA-regulated deposit takers, general insurers, life insurers and home finance providers must also (in addition to the FCA FSCS funding classes) contribute to the pool.
- With effect from 1 April 2014, the potential for the FSCS to smooth the impact of levies by looking further ahead at potential compensation costs expected in the 36 months following the levy instead of 12 months, as at present.

Consumer engagement and insight

Maintaining good links with a range of external consumer bodies has helped the FSA gain insight into the problems faced by consumers. Connections with these groups also helped the FSA communicate with consumers. These bodies, including Money Advice Service, form an important part of how the FSA carries out its duties to consumers. Dialogue with consumer groups forms an important part of the FCA's strategy going forward.

In 2012/13 the FSA developed a consumer organisation network which will continue under the FCA. This comprises of consumer organisations from across the UK that meet twice a year.

The members are:

- Citizens Advice England
- Citizens Advice Wales
- Citizens Advice Scotland
- Citizens Advice Northern Ireland
- Money Advice Scotland
- The Consumer Council of Northern Ireland
- Advice UK
- Age UK
- SCOPE
- Which?

- Money Advice Trust
- Stepchange
- Toynbee Hall

The network has the following objectives:

1. Establish and maintain productive and trusting relationships with consumer organisations.
2. Create improved flows of information and insight between consumer organisations and the FSA.

The FSA also established consumer insight training that provided FSA staff with an insight in to the needs and vulnerabilities of UK consumers. Further training to provide staff with an understanding of consumer behavioural biases when selecting products will continue under the FCA.

The FSA's Consumer Helpline continued to provide guidance to members of the public who have questions or concerns about their financial provider or about a financial product. The Consumer Helpline received calls on a wide variety of topics such as general insurance, investments, and banking as well as calls regarding scams or other financial crimes. Other enquiries this year included topics such as LIBOR, the eurozone and Payment Protection Insurance (PPI).

Engaging with consumers

The FSA recognised that in order to look at regulation from a consumer's point of view it needed to work closely with consumer organisations so it can understand issues and emerging problems. The FSA used various methods of engagement with a range of consumer organisations within and outside of this network. It aimed to work with consumer representative organisations in ways which recognise their limited resources to engage with the FSA.

As part of its engagement work with consumer organisations the FSA held a day-long event engaging with young people in Govan, Glasgow, to understand what mattered to them when it came to using financial services. To ensure the FSA got the most from this event it worked in partnership with the national Scottish youth charity Young Scot. The FSA also spent a day with the Women's Institute to learn about the impact of financial product choices and to hear from their members what they expected from a financial conduct regulator.

Customer Contact Centre – Projects and people

This year, work was undertaken to improve the service provided to the FSA's customers – both firms and members of the public – from the firm and consumer contact centres. This involved a wholesale review of the quality assurance process, which is a framework for continuously monitoring whether it provided customers with the information they required in a clear, accurate and timely manner.

The new framework quickly identified areas where the FSA could improve its service and enabled it to target additional technical training for contact handlers, ensuring it gave accurate and informative responses to enquiries, and ultimately provided a better service. The FSA saw an 82% increase in productivity in responding to correspondence, and it maintained its call productivity. The FSA continued to build on the breadth and depth of staff knowledge in the Contact Centres throughout 2012; and this helped it to significantly increase the productivity of its correspondence teams.

It is important for the people who contact the regulator to have trust in the answers and guidance that it provides. The Customer Contact Centre gained full accreditation to the Customer Contact Accreditation's Global Standard, which helped enhance trust.

The FSA also successfully delivered a project to set up a firm enquiries function in the BoE to take prudential calls.

Redress

Since December 2010 the FSA has secured £320m in redress and payments to consumers in relation to cases where it has taken enforcement action.

Arch Cru

In December 2012 the FSA announced a redress scheme for investors in CF Arch Cru Funds. The FSA concluded that there had been widespread mis-selling by IFAs who failed to assess the funds as high risk despite the fact that they were typically invested in non-mainstream assets such as private equity, private finance and commodities.

The FSA published a Policy Statement on 17 December 2012 outlining the implementation of a consumer redress scheme for investors in the CF Arch Cru fund range. This followed on from the Consultation Paper it issued in April 2012 describing its proposals for a consumer redress scheme in relation to widespread mis-selling of Arch Cru funds by financial advisers. The FSA's analysis reviewed 179 files from a random sample of 24 firms and identified that the advice was unsuitable in 78% of cases, primarily because the funds were high risk and many consumers were not willing or able to take this level of risk within their portfolio.

The consumer redress scheme rules were introduced on 1 April 2013. Under the scheme rules, firms must write to consumers inviting them to have their advice reviewed. If consumers opt-in to the scheme, then firms are required to review the advice by 9 December 2013 and pay redress where the advice is deemed unsuitable, and consumers have suffered a loss as a result of the advice.

Interest Rate Hedging Products (IRHPs)

In 2012 the FSA carried out a review of the sales of IRHPs by four of the largest UK retail banks to small businesses. The results of this review identified significant failings including the inappropriate sale of complex varieties of IRHPs to 'non-sophisticated' customers and a range of poor sales practices. In June and July 2012 the FSA announced that ten banks had agreed to conduct a proactive redress exercise and past business review in relation to their sales of IRHPs to small businesses. Each of the banks' reviews would also be overseen by an independent Skilled Person appointed using powers granted to the FSA under Section 166 of FSMA. Following an initial pilot exercise in late 2012 the banks are expected to progress to the full review exercise in 2013.

PPI

Ensuring appropriate redress is paid to those who were mis-sold PPI remained a priority for the FSA. Over the course of this financial year its focus moved from educating and assisting firms in understanding its complaint handling measures to monitoring firms to ensure they were delivering fair redress in practice. As a result, consumers received in excess of £6.1 billion in redress over the course of the financial year.

In February 2013 the FSA fined Lloyds Banking Group (LBG) £4,315,000 for failings in their systems and controls that resulted in up to 140,000 customers receiving delayed PPI redress. LBG failed to establish an adequate process for preparing redress payments to send to PPI complainants and, as a result, LBG's systems were unable to process the very large volumes of PPI redress payments that it needed to make in a timely way. In addition, there were deficiencies in LBG's monitoring of PPI redress payments and LBG's approach to risk management when preparing the payments to send to PPI complainants was ineffective.

The FSA also fined the Co-operative Bank plc. (Co-op) £113,000 for failing to handle PPI complaints fairly. During the British Bankers Association unsuccessful high court challenge of FSA measures, which were published in 2010 and designed to ensure that all PPI complainants were treated fairly, Co-op incorrectly put on hold PPI complaints that were capable of being progressed. Co-op put these complaints on hold, despite the FSA making it clear to the industry, that many claims could be progressed normally as the judicial review was in progress. The FSA's review of a sample of complaints that were put on hold revealed that 100% of the cases examined could have been progressed.

Keydata update

The FSA's disciplinary proceedings against Keydata and its former CEO were put on hold in late 2010 while Mr Ford's judicial review, which concerned his claim to joint legal privilege over a limited category of documents, was heard by the Court. On 11 October 2011, the High Court found that Mr Ford could claim joint privilege with Keydata regarding two of the eight documents being reviewed. On 12 June 2012, the Court made an Order regarding the remedies Mr Ford had requested to the effect that the FSA cannot use these two documents in its disciplinary proceedings. Mr Ford is now seeking permission to appeal this decision to the Court of Appeal, and in the meantime, the disciplinary proceedings remain on hold. FCA work in this area remains a priority.

International policy initiatives

AIFMD

Member States are required to implement the AIFMD by 22 July 2013. The AIFMD aims to:

- Mitigate the build-up of systemic risk by enhancing the supervision of Alternative Investment Fund Managers (AIFMs) across the EEA to support timely and pre-emptive action.
- Improve investor protection by imposing new depositary standards and enhanced transparency through new disclosure and reporting rules.
- Promote competition in the EEA by providing harmonised rules and an EEA-wide passport for full-scope EEA AIFMs to market and manage AIFs from 22 July 2013.

The FSA consulted on UK implementing measures, including changes to FSA rules on prudential requirements for fund managers and on the regime for depositaries, in the Consultation Paper (CP12/32), published on 14 November 2012. The FSA published a second Consultation Paper in Q1 2013 on further implementing measures covering subjects such as:

- marketing arrangements under AIFMD;
- arrangements to implement the Treasury's proposals for specialised regimes for smaller (sub-threshold) alternative investment fund managers;

- the application of the FSCS and FOS; and
- fee-raising arrangements for all firms within scope of AIFMD.

The FSA worked within ESMA to develop technical standards and guidelines on implementing measures related to AIFMD, such as types of AIFMs and Alternative Investment Funds, remuneration of key staff, and reporting requirements for firms, as well as international supervisory cooperation agreements with regulators in major non-EEA jurisdictions.

UCITS

The European Commission adopted the UCITS V proposal on 3 July 2012. The proposal focuses on rules around depositaries, remuneration and sanctions and mostly aims to ensure an alignment of UCITS with AIFMD. Working closely with the Treasury the FSA participated in the on-going negotiations in the European Council.

Insurance Mediation Directive (IMD2)

In July 2012 the European Commission adopted a proposal for a revised IMD2. The Commission proposes that the scope of IMD2 be extended to encompass more firms that sell insurance, notably insurance undertakings, as well as introducing new disclosure rules and a higher level of sales standard for insurance investment products - like those in MiFID. The proposal is currently being debated in the European Parliament and Council of Ministers; the FSA worked with the Treasury and the UKRep to provide support and input in the legislative process so far.

Packaged Retail Investment Products (PRIPs)

In July 2012 the European Commission also adopted a proposal for a regulation for a new Key Information Document to be produced by investment product manufacturers and provided to retail customers when they are considering buying certain investment products. The regulation will set common product information standards for various different PRIPs. The proposal is now under negotiation in the European Parliament and Council of Ministers. The FSA worked with the Treasury, and the UKRep to provide support and input throughout the legislative process to date, seeking to influence policy thinking and to ensure a good outcome for investor protection.

Payment services and electronic money

During the year, the FSA worked with the Treasury, and liaised with stakeholders, to form the UK's contribution to the European Commission's review on the Payment Services Directive. The FSA recommended that the review seeks to deliver a simpler, more coherent regulatory structure by reviewing the Payment Services Directives and the second Electronic Money Directive in parallel and incorporating any initiatives arising from the Green Paper on card, internet and mobile payments. The European Commission has accepted the importance of combining the review of the Payment Services Directive with the Green Paper initiatives but has postponed the review of the E-money Directive because it has not yet been implemented by some Member States.

Compensation and dispute resolution directives

Deposit Guarantee Schemes Directive (DGSD)

DGSD requires Member States to establish a deposit guarantee scheme. The UK meets this obligation through the FSCS. As part of this, depositors are protected up to £85,000 (€100,000) per depositor per authorised deposit taker, and the DGSD requires payout to be achieved within 20 working days (though the UK has a target seven day payout for most depositors).

In 2010 the European Commission proposed a recast of the DGSD. This included proposals requiring pre-funding, the use of funds to pay for resolution actions, mutual borrowing between Member States, risk-based levies, a reduction in the payout deadline to seven days, harmonised eligibility criteria and consumer disclosure requirements.

Investor Compensation Schemes Directive

The European Commission's 2010 proposals for amendments to the Investor Compensation Scheme Directive remain subject to negotiation, but the dossier has made no further progress through the EU legislative process since November 2011.

Throughout 2012 the FSA continued to work with the Treasury to support its development of a UK strategy for influencing and securing amendments, when negotiations recommence, which:

- enable the FSCS to continue to provide investors with at least the existing amount of protection it currently provides; and

- are proportionate and operationally achievable in respect of funding arrangements.

Dispute resolution procedures

The texts for a directive on Alternative Dispute Resolution and a regulation on Online Dispute Resolution were agreed informally between the European Parliament and Council in December 2012 and they will be formally adopted by the European Parliament and Council in 2013. Throughout 2012 the FSA worked closely with BIS and Financial Ombudsman Service to ensure that the proposals maintained existing confidence in the FSA (and Financial Ombudsman Service) and would not impose a disproportionate burden on industry.