Consultation Paper

CP12/35★★★

Financial Services Authority

The FCA's use of temporary product intervention rules

FSA®

Financial Services Authority

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The Financial Services Authority invites comments on this Consultation Paper. Comments should reach us by 4 February 2013.

Comments may be sent by electronic submission using the form on the FSA's website at: www.fsa.gov.uk/Pages/Library/Policy/CP/2012/cp12-35-response.shtml.

Alternatively, please send comments in writing to:

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A confidential response may be requested from us under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Tribunal.

Copies of this Consultation Paper are available to download from our website – www.fsa.gov.uk. Alternatively, paper copies can be obtained by calling the FSA order line: 0845 608 2372.

Abbreviations used in this paper

ESAs	The European Supervisory Authorities
FCA	Financial Conduct Authority
FSA	Financial Services Authority
FSMA	Financial Services and Markets Act (2000)
MiFID	The Markets in Financial Instruments Directive
PPI	Payment Protection Insurance
PRA	Prudential Regulation Authority
UCIS	Unregulated Collective Investment Scheme

1 Overview

Why we are publishing this paper

1.1 We are consulting on when and how the Financial Conduct Authority (FCA) may make temporary product intervention rules. In this Consultation Paper we explain the nature of some of the situations in which it may choose to do this and give examples. We also set out the FCA's draft Statement of Policy on making temporary product intervention rules.

Background

1.2 In January 2011 we published a Discussion Paper[1] in which we introduced a range of possible product interventions as part of our new approach to regulating retail financial services. In June 2011 we published a Feedback Statement[2] in which we stated that we may consider the use of these interventions as part of our range of tools to protect consumers.

1.3 These possible interventions, some of which may require new rules to be made, or changes to existing rules, include:

- consumer or industry warnings;
- a requirement that certain products are only sold by advisers with additional competence requirements;
- preventing non-advised sales or marketing of a product to some types of consumer;
- a requirement for providers to amend promotional materials;
- a requirement for providers to design appropriate charging structures;
- banning or mandating particular product features; and
- in rare cases, banning sales of the product altogether.

1 DP11/1: '*Product Intervention*', (January 2011): at www.fsa.gov.uk/pubs/discussion/dp11_01.pdf
2 FS11/3: '*Product Intervention*', (June 2011): www.fsa.gov.uk/pubs/discussion/fs11_03.pdf

1.4 The Financial Services Bill (the Bill) makes it explicit that the power to make product intervention rules is included in the FCA's power to make general rules.[3] The FCA will consider the use of interventions such as the types listed above, when going about its work.

1.5 In the *Journey to the FCA*,[4] we said that the FCA will intervene earlier and will have a lower risk tolerance than the FSA, in order to ensure an appropriate degree of consumer protection.[5]

1.6 In most situations, the FCA will consult on permanent rules which it makes with the aim of protecting consumers. The Bill also provides that the FCA may make temporary rules before any consultation where it considers it "necessary or expedient… for the purpose of advancing the consumer protection objective or the competition objective, or, [if an order from the Treasury is provided,] the [market] integrity objective".[6]

1.7 The Bill requires that such rules do not last more than 12 months, and may not be renewed. A temporary rule lasting up to one year will give the FCA enough time to give appropriate consideration to the consumer protection problem and, if necessary, make and consult upon a permanent solution, or the problem may be righted in some other way.

1.8 In this document, we refer to product intervention rules made before any consultation as *temporary product intervention rules*.

The status of the Statement of Policy

1.9 The Bill requires the FCA to prepare and issue a statement of its policy with respect to the making of temporary product intervention rules,[7] and to publish a draft of the proposed statement and to invite representations about the proposal.[8] This Consultation Paper is intended to meet this requirement, and is being undertaken by us on behalf of the FCA, with a view to having a final version of the Statement available in time for legal cutover on 1 April 2013.

1.10 Please note that the Statement itself does not introduce any rules, and so it is different from an FSA Policy Statement which is published following consultation on new rules, or a change to existing rules. It merely sets out what we propose that the FCA's policy will be, and the process it will follow, when it considers making temporary product intervention rules.

3 Financial Services Bill, s. 137C: www.publications.parliament.uk/pa/bills/lbill/2012-2013/0025/2013025.pdf.
4 '*The Journey to the FCA*', (October 2012): www.fsa.gov.uk/static/pubs/other/journey-to-the-fca-standard.pdf. See also: '*The FCA approach to regulation*', (June 2011): www.fsa.gov.uk/static/pubs/events/fca_approach.pdf.
5 The FCA will assume the FSA's responsibility for consumer protection on 1 April 2013.
6 Financial Services Bill, s. 138M
7 Financial Services Bill, s. 138N
8 Financial Services Bill, s. 138O

The structure and scope of this consultation

1.11 We hope that reading this paper will provide some clarity on the FCA's intentions when making temporary product intervention rules. However, we can not, and do not, intend to predict every circumstance in which the FCA might make these rules. Such circumstances will depend on the problems that the FCA will encounter in the future, its assessment of the risk posed by those problems and the immediacy of that risk, and the other options available to address the problem.

1.12 In Chapter 2 of this paper, we examine how making temporary product intervention rules might advance the FCA objectives, and provide some further explanation of why the FCA might make these rules in practice.

1.13 In Chapter 3, we examine how temporary product intervention rules will be published, maintained and enforced, and how we expect that the FCA will manage the impact of such rules upon innovation, products already in the market, fees, European legislation and equality.

1.14 The proposed text of the Statement of Policy is in Chapter 4. We provide a market failure analysis[9] and compatibility statement in the Annex.

Who should read this paper

1.15 We believe that this paper will interest all product provider and distributor firms who will be regulated by the FCA, and industry associations. It should also be of significant interest to consumers and consumer groups.

1.16 As other regulators and regulatory bodies are considering similar issues, particularly in the EU where future directives might include the ability for national regulators and the European Supervisory Authorities (ESAs) to make product interventions, they may also be interested in this consultation.

Next steps

1.17 Following the consultation period, we will publish the final text of the Statement of Policy. We believe that a two-month consultation period is adequate for interested parties to raise comments about the Statement, and will allow us to have the final Statement in place in time for legal cutover. This text will published on the FCA website following legal cutover.

9 Please note that since this Consultation Paper does not in itself make any rules, we have not provided a cost-benefit analysis.

2

Making temporary product intervention rules

2.1 In this section, we examine how making temporary product intervention rules is consistent with the FCA's earlier intervention strategy, and how it might make such rules in order to further each of its objectives. We also set out some of our current thinking on the circumstances that might make it necessary for the FCA to make temporary product intervention rules.

Temporary product intervention rules and the FCA's approach to earlier intervention

2.2 We have learned from previous major product failures that earlier intervention can be more effective and efficient than waiting until after the event. We expect that most improvements in consumer outcomes from the FCA's earlier intervention strategy will arise from improvements the way that it gathers intelligence (such as listening to comments from consumer organisations and whistleblowers), an increased focus on product governance, a new style of supervision of firms (both provider and distributor), and the introduction of permanent product intervention rules from a range of possible options (including those listed in paragraph 1.3 of the document).[10]

2.3 Where the FCA identifies a risk of significant consumer detriment which requires urgent action, it will consider the use of temporary product intervention rules.

2.4 We consider that product intervention rules generally, and the ability to make temporary product intervention rules where required, will prove to be a valuable tool as part of the FCA's earlier intervention strategy. However, making temporary product intervention rules will be just one part of this strategy. We do not expect the FCA to make temporary product intervention rules regularly, and where they are used, it will be with careful consideration.

10 *Journey to the FCA*, p.13

Making temporary product intervention rules to advance FCA objectives

Consumer protection

2.5 Generally speaking, the FCA is likely to find it necessary or expedient to make temporary product intervention rules where urgent product-related issues arise in the market, which are deemed likely to cause significant consumer detriment if left unaddressed for the time it would take to consult on product intervention rules. These are expected to be cases of serious concern where to delay action would jeopardise the FCA's effectiveness in delivering on its consumer protection objective and/or produce a significant redress bill for the industry.

Competition

2.6 Firms may create products in such a way that makes it difficult for competition to function effectively, such as using complex pricing structures that make it harder for consumers to shop around. But even if competition is vigorous it can be ineffective. Competition that is focused on exploiting consumer biases or information asymmetries may harm consumers. For example, intense competition between banks for current account customers has focused on highly visible features, which exploited consumers' overconfidence that they would not go overdrawn and incur charges or other less visible fees. We examine some of these aspects of imperfect competition in our market failure analysis in Annex 1.

2.7 Where the FCA observes urgent and significant problems which are unlikely to be corrected by the market, it may use temporary product intervention rules to further its objective to promote effective competition, and to fulfil its duty to promote effective competition when it acts to advance its other objectives.

Market integrity

2.8 The Bill states that the FCA may make temporary product intervention rules to advance the market integrity objective, where it is ordered to do so by the Treasury.[11]

Applying temporary product intervention rules in practice

2.9 Although it is not possible to provide complete certainty around how and when the FCA will use temporary product intervention rules in the future (whether permanent or temporary), here we set out some broad, general examples of the kind of scenarios in which they might be used:

11 Financial Services Bill, s. 138M

- products that would be acceptable but for the inclusion or exclusion of particular features;
- products where there is a significant incentive for inappropriate or indiscriminate targeting of consumers;
- markets where firms restrict their product range or access to their product range in ways designed to increase profitability by restricting consumer choice, reducing competition, or creating barriers to search, switching, or entry;
- products which may bring about significant detriment as a result of being inappropriately targeted; or
- in some particularly serious cases, a product may be considered inherently flawed – for example, a product that has such disadvantageous features that the majority of consumers, or specified types of consumer, are unlikely to benefit.

2.10 It is possible that the FCA will identify markets or products where lack of competitive pressure may create the potential for consumer detriment. The FCA may make temporary product intervention rules to address products or practices which exploit systematic demand-side weaknesses, or combinations of demand-side weaknesses, in such a way that market-based solutions will not address the problem. Some examples of these weaknesses are illustrated below:

- a product, or a feature of a product or group of features, might be so complex that most consumers, or a particular type of consumer, would be unable to understand, or would have difficulty understanding the risks or features of the product they are purchasing, with the result that the appropriate outcomes are unlikely to be achieved;
- certain product features which are not integral to the effective operation of the product might unduly restrict search or switching;
- some features may be designed to exploit consumers' focus on the headline price or other near-term features, as opposed to outcomes in the long term;
- a product may be designed to frame consumer choice in a potentially misleading way;
- certain products may represent an irregular purchases or one-off purchase over a customer's lifetime, and consumers may have difficulty in applying competitive pressure to providers, for example by switching; and
- products may be bundled (sold as a group of products for a single price) or tied (where the sale of a product is conditional on another sale) in a way that creates the potential for consumer detriment, by unduly restricting the consumer's access to individual components where the other elements of the bundled or tied products may not be useful to – or valued by – them.

2.11 It is important to note that these examples are indicative only. They are not intended to comprise an exhaustive list of the factors which would need to be present before the FCA might consider using product intervention rules (and temporary product intervention rules, where it identifies an urgent need to act) in future, and nor do they mean that the FCA will definitely make such rules where it identifies any of these circumstances, or any combination of these circumstances.

Q1: Do you agree with our analysis of some of the circumstances in which temporary product intervention rules might be necessary?

Q2: In what other circumstances might it be necessary to make temporary product intervention rules?

3

Maintenance and impact of temporary product intervention rules

3.1 In this section, we examine how we expect the FCA will ensure that the temporary product intervention rules it makes are transparent and that it minimises the potential for any adverse impact on consumers, firms and markets arising from these rules.

Publishing rules created under the Statement of Policy

3.2 The Statement of Policy outlines the process the FCA intends to use when making temporary product intervention rules. Any temporary product intervention rules which are produced as a result of a decision being taken by the FCA's Board will be published on the FCA website. When making such rules, the FCA will state the duration of the rule (to a maximum of 12 months) and the date from which it will be effective. At the end of that period the temporary product intervention rule will be deemed to have lapsed and will cease to have effect.

3.3 Temporary product intervention rules will be contained within the FCA Handbook for the duration that they are in effect.

3.4 When temporary product intervention rules are disapplied, replaced by other rules, or withdrawn for some other reason, the FCA will publish a statement on its website stating that the rule is no longer in effect. However it is unlikely to do this when a temporary product intervention rule lapses at the end of the period specified when the rule is published.

3.5 Given the likely urgency when making and publishing temporary product intervention rules, the FCA is unlikely to have the opportunity to contact all affected firms directly either before or when it publishes the rule, although it will make reasonable endeavours to ensure that information about the rule is communicated as widely as possible. Firms should as usual take their own steps to ensure that they appraise themselves of regulatory decisions taken and new rules made by the FCA. It is likely that the use of these rules will generate significant media interest, and as a result it is unlikely that provider firms will remain unaware of FCA actions.

Q3: Will our proposed approach create an appropriate level of awareness amongst firms affected by temporary product intervention rules?

Q4: How should the FCA balance the need for clarity and awareness in the market against the likely need for urgent action when making temporary product intervention rules?

Revisions and updates to the Statement of Policy

3.6 The Bill provides for the FCA to alter or replace the Statement of Policy following publication of the final Statement.[12] It is possible that the FCA will make changes to the Statement as a result of issues that are brought to its attention, from its experience of using the process, or resulting from a review of the Statement.

3.7 Where the FCA makes revisions to the Statement which it deems to be significant, it will consult on these revisions in the normal way. It will publish minor changes or points of clarification on its website.

Temporary product intervention rules and the FCA's new unenforceability provision

3.8 When making any product intervention rules, the FCA will decide whether to incorporate unenforceability provisions.[13] The unenforceability measures would only apply to agreements entered into after the product intervention rules are introduced and in contravention of those rules. Arrangements entered into before the introduction of such rules would not be subject to the unenforceability and automatic compensation rules. Consumers seeking redress in relation to such arrangements would still need to establish their claims in the usual way.

3.9 However, please note that arrangements in breach of existing rules (such as mis-selling) before the FCA introduces a particular temporary product intervention rule will still be subject to enforcement or other regulatory actions.

12 Financial Services Bill, s. 138N
13 These provisions are set out in s.137C(7) of the Financial Services Bill.

The impact on existing customers and products already in the market

3.10 It is possible that some temporary product intervention rules might have an adverse impact on some consumers who hold those products, or other products.

3.11 Where the FCA identifies consumers holding products that may be affected by proposed temporary product intervention rules, it will attempt to identify possible negative implications of the rule for those existing consumers, and balance these against its duty to protect consumers in general. If it concludes that the need to protect potential consumers of the product is greater than the potential harm to existing consumers, then it will make the rule.

> **Q5:** How can the FCA best protect consumers who hold products which might be affected by temporary product intervention rules?

The European context

3.12 The FCA will be subject to the wider EU legislative framework, and this may have implications for firms which practise cross-border business.

3.13 Where a product provider is domiciled overseas, FCA rules would not apply to the development of potentially harmful products by such firms. However, where such products from overseas providers are sold by intermediaries based in the UK, they may be subject to regulatory action by the FCA, which may include some forms of temporary product intervention rule (such as marketing restrictions). Where the FCA observes such issues, it will work with the European Commission, the ESAs, or the relevant overseas regulator as appropriate.

3.14 The potential scope of general product intervention rules is also being discussed at EU level and will likely become a feature of financial services regulation in the EU.

3.15 Provision for product intervention rules feature, for example, in the European Commission's recent proposal for the revised Markets in Financial Instruments Directive (MiFID). The recent work of the ESAs also reflects an increased focus on product intervention, product governance and supervision of product providers. The FCA will continue to support the adoption of product intervention powers at EU level.

3.16 When making temporary product intervention rules (and indeed product intervention rules more generally), the FCA will have due regard to how any proposed rules fit within the wider EU legislative framework in their discussions.

The impact on fees

3.17 We do not anticipate that our publishing this Statement, or any temporary product intervention rules made by the FCA, will have implications for fees. While making temporary rules will not be without cost to the FCA, it will undertake any action as part of its business as usual work. Such costs to the FCA will be spread across the appropriate fee-blocks in the same manner as other regulatory costs.

Enforcement of temporary product intervention rules

3.18 For the purposes of enforcement, temporary product intervention rules will be treated in the same manner as any other rules made under the FCA's general rule-making power.

Working with industry to improve consumer outcomes

3.19 Before making temporary product intervention rules, where possible, the FCA will examine alternative methods of mitigating consumer detriment in the time available before such a rule is made. These options might include directly contacting the product provider or providers and seeking a voluntary arrangement which offered an appropriate degree of protection, where time allowed.

3.20 Firms are unlikely to be affected by product intervention rules which may be introduced by the FCA, including temporary product intervention rules, if the design of their products is right for their customers, and if they distribute products in a way which treats their customers fairly.

The impact upon innovation and market entry

3.21 We are aware of concerns that the ability to make rules before any consultation might act as a deterrent to innovation and could restrict new entry to financial markets. The reason for these concerns is that providers may be unwilling to invest in product development if they believe that there is a risk that new products will be banned from sale or have their routes to market restricted in some other way, leaving firms unable to recoup their costs. In addition, provider firms may argue that they are unwilling to market products if they do not have full control over the distribution chain, given the risk of mis-selling by intermediary firms.

3.22 While we acknowledge such concerns, we do not consider that the FCA using temporary product intervention rules will raise barriers to entry or have a significant detrimental effect on innovation, which would not be outweighed by a positive effect on consumer protection, for the following reasons:

- The FCA's focus on earlier intervention, including the use of temporary product intervention rules, will not exempt either providers or distributors of their responsibilities to treat customers fairly, and for the need for both types of firm to have adequate product governance.[14]
- We consider that provider firms will be able to set realistic expectations about the potential for negative consumer outcomes arising from the sale of their products, and to put in place a strategy for minimising the risk of these outcomes, and will still perceive the opportunity to make returns from their products after balancing the prospect of regulatory action. For this reason we expect that the impact of the possibility of temporary product intervention rules on benign market entry will be limited.
- And in drafting the Statement of Policy we have created general principles which will require the FCA to give appropriate consideration to ensure that temporary product intervention rules are the most appropriate solution and are used proportionally.

3.23 In *Journey to the FCA*, we are clear that in future the FCA will be prepared to go further than the FSA in challenging firms about the value for money offered by their products.[15] The FCA may elect to use temporary product intervention rules where it identifies an urgent need for action in this area.

3.24 However, it should be made clear that the FCA will not be a pure economic regulator in the sense of setting levels of return for particular products (as happens in some utility markets). This is in line with the government's stated objectives for the FCA.

> **Q6:** Do you agree with our analysis of how temporary product intervention rules might impact upon innovation and market entry?

Equality impact assessments

3.25 The Statement sets out the procedure that the FCA will follow when making rules, and does not constitute rules in itself. It will not bring about any changes in the range of products available to consumers, or the ability of consumers to access those products. For this reason, we consider that publication of the Statement of Policy will have no impact on vulnerable groups.

3.26 It is possible that temporary product intervention rules which are made according to the process contained within the Statement of Policy may have an impact on vulnerable consumers. The FCA will consider these issues as part of an Equality Impact Assessment when making temporary product intervention rules.

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14 See section 1.20 of the Responsibilities for Product Providers and Distributors for the Fair Treatment of Customers: http://media.fsahandbook.info/Handbook/RPPD_20070716.pdf.

15 *Journey to the FCA*, p.13

Q7: What issues should we consider in relation to how this Statement of Policy affects equality and diversity?

4

Statement of Policy for making temporary product intervention rules

4.1 This chapter forms the draft text for the FCA Statement of Policy for making temporary product intervention rules. Please note that this Statement will be published on the FCA website, so in the text in this chapter 'we', 'our' and 'us' refers to the FCA rather than the FSA.

4.2 Please note that references to the Financial Services and Markets Act 2000 (as amended) relate to FSMA as we expect that it will be made following the progress of the current Financial Services Bill.

Introduction

1. In general terms, product intervention rules are rules made under s. 137C of the Financial Services and Markets Act 2000 (as amended) (FSMA) aiming to tackle issues relating to specific products (or types of products), product features or marketing practices relating to specific products. They exist alongside other regulatory tools, such as other general rules, guidance, Variations of Permission[16] and supervisory and enforcement action.

2. Product intervention rules made without consultation (under s. 138M of FSMA) are limited to a maximum duration of 12 months and are referred in this document as 'temporary product intervention rules'.

3. Temporary product intervention rules will offer protection to consumers in the short term while allowing either the FCA or industry to develop a more permanent solution to address the source of detriment. They may also be made in response to urgent competition or (if applicable) market integrity issues.

16 By the regulator, known as Own Initiative Variations of Permission (OIVoP).

4. This statement sets out our policy on the making of temporary product intervention rules.[17] This statement is required by s.138O of FSMA.

Temporary product intervention rules

5. The FCA is normally obliged to consult the public before making any rules. However, FSMA provides a general exemption to this requirement if we consider that the delay involved in complying with the requirement would be prejudicial to the interests of consumers.[18]

6. A specific exemption to the consultation requirement is provided (s. 138M) in relation to the making of temporary product intervention rules. We may make rules about product intervention without consultation if we consider that it is necessary or expedient not to comply with such requirement to advance:

   a) the consumer protection objective;

   b) the competition objective; or

   c) if the Treasury makes such an order, the market integrity objective.

7. Decisions to make any rules, including temporary product intervention rules, will be taken by the FCA Board.

8. In publishing temporary product intervention rules, we will also publish the rationale for these rules.

Factors the FCA will consider when making temporary product intervention rules

9. In general terms, we will consider a product intervention rule where we identify a risk of consumer detriment arising from a particular product, type of product, or practices associated with a particular product or type of product. In deciding whether the rule should be made as a temporary product intervention rule, our main consideration will be whether prompt action is deemed necessary in seeking to reduce or prevent consumer detriment arising from that product, type of product or practices. It will also have regard to the other considerations set out below.

Competition considerations for product intervention rules

10. In making product intervention rules (whether or not temporary, and as with any other rule), we will seek to promote effective competition in the interests of consumers where

17 In this document, 'Temporary product intervention rules' are product intervention rules made without prior consultation as defined in s.138M.

18 The interests of consumers are defined in s.425A.

doing so is compatible with its consumer protection objective (or the integrity objective, if the Treasury provides by order for such objective to extend to product intervention rules).

11. Relevant competition-related considerations for the FCA in the context of product intervention rules are likely to include:

a) whether there is reasonable scope for the rule under consideration to promote effective competition in the interests of consumers, for instance by addressing consumer behaviours that impair their ability to benefit from competition, by reducing information asymmetries or by correcting misaligned incentives;

b) whether the rule under consideration may have a negative impact on competition factors such as product innovation and barriers to entry for new market participants;

c) whether any negative impact on competition factors is proportionate, having regard to the aims of the rule under consideration;

d) whether alternative solutions may deliver the same intended outcome while having a more positive impact on competition; and

e) the overall effect of a proposed rule upon the operation of effective competition in the market for financial services, having regard to the interests of consumers.

12. Where promoting competition would be in conflict with the consumer protection or (if applicable) market integrity aims of a proposed temporary product intervention rule, the consumer protection or market integrity aims will take precedence over competition considerations.

Contextual considerations for product intervention rules

13. In considering whether to make product intervention rules in response to an identified product-centred issue, we will generally consider factors such as:

a) the potential scale of detriment in the market – issues involving products with a large or potentially large customer base are more likely to require product intervention;

b) the potential scale of detriment to individual customers – issues that may lead to high detriment for individual customers are more likely to require product intervention;

c) the social context – issues that may lead to detriment for particular groups of customers (such as, in particular, vulnerable customer groups) are more likely to require product intervention;

d) the market context – market mechanisms such as information disclosure and competition do not always work to protect consumers; and

e) possible unintended consequences – whether the use of temporary product intervention rules or the timing of the intervention would in itself create undue risk of further consumer detriment, including harm to existing customers in the market (although this will not comprise a full cost benefit analysis).

General considerations for product intervention rules

14. In addition to above, in making product intervention rules (whether or not temporary) we will have regard to the regulatory principles set out in FSMA (s. 3B) and to general considerations that include, but are not limited to, whether the proposed rules are:

a) an appropriate and effective means of addressing actual or potential consumer detriment associated with a particular product or group of products;

b) a proportionate and deliverable means of addressing actual or potential detriment;

c) an appropriate means to improve competition within the market;

d) transparent in their aim and operation; and

e) likely to be beneficial for consumers, when taken as a whole.

15. We will also consider the risk that the rules have a negative impact on protected groups in the Equality Act and whether the rules can promote equality and good relations.

Revocation or replacement of rules

16. When making temporary product intervention rules, we will state the duration of the rule and the date from which it will be effective. Temporary product intervention rules will have a maximum duration of 12 calendar months from when the rule is made, but we may decide on a shorter duration for a rule.

17. We may review or revoke temporary product intervention rules at any time before the end of the period for which they apply.

18. Rules may be revoked or changed for a number of reasons, including but not limited to:

a) new rules are introduced on a permanent basis following a consultation exercise;

b) new rules being introduced at the EU level;

c) industry initiatives are developed that specify sufficient minimum standards to address the sources of consumer detriment;

d) further evidence is submitted that demonstrates that consumer detriment will not occur;

e) demand for, or supply of, the relevant product disappears and is deemed unlikely to return; or

f) we identify unforeseen negative effects of the rule which outweigh any positive impact upon consumer protection.

19. Where temporary product intervention rules have been made, we may not make further temporary product intervention rules containing the same, or substantially the same, provisions within the prohibited period. This period is 12 months beginning on the day on which the limited duration of the initial rules ends (whether or not the rules were revoked early). The prohibited period does not apply to rules that are not temporary product intervention rules (i.e. rules which have been made subject to consultation, whether or not of a set duration).

General rule making and product intervention

20. FSMA empowers us to make general rules as appear necessary or expedient for the purpose of advancing one or more of its operational objectives (s. 137A).

21. It also confirms that we may use our general rule-making power to prohibit authorised persons from entering into specified agreements (s.137C).[19] These rules may be made to advance:

a) the consumer protection objective;

b) the competition objective; or

c) if the Treasury makes such an order, the market integrity objective.

22. The FCA may prohibit:

a) entering into specified agreements[20] with any person or specified person[21];

b) entering into specified agreements with any person or specified person unless requirements specified in the rules have been satisfied;

c) doing anything that would or might result in the entering into of specified agreements by persons or specified persons, or the holding by them of a beneficial or other kind of economic interest in specified agreements;

d) doing anything within paragraph c) unless requirements specified in the rules have been satisfied.

23. S.137C(2) makes it clear that a range of options would be available to us in making rules prohibiting authorised persons from entering into specified agreements.

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19 The FSA has already outlined the kind of product interventions which it may undertake in FS11/03: at www.fsa.gov.uk/pages/Library/Policy/DP/2011/fs11_03.shtml.

20 'Specified agreements' are those meeting the description specified in rules by the FCA. It is of no relevance whether the entering into of a specified agreement itself constitutes the carrying on of a regulated activity or whether, in a case within paragraph 2.3 (c) or (d), the specified agreements are with the authorised persons concerned or anyone else.

21 'Specified persons' are those meeting the description specified in rules by the FCA.

24. The extent and intrusiveness of the rules which are made will generally depend on the type of intervention deemed necessary to address effectively the problems identified, having regard to whether the intervention would be a proportionate response to the perceived risk to consumers, competition failings or, if applicable, market integrity issues.

25. Rules may range from requiring certain product features to be included, excluded, or changed, or requiring amendments to promotional materials, to imposing restrictions on sales or marketing of the product or, in more serious cases, a ban on sales or marketing of a product in relation to all or some types of customer.

26. Where the product is provided by a business outside of the UK, rules may be made targeting regulated activities by authorised persons in the UK that would lead to a specified agreement being formed (see s.137C(2)(c) and (d)).

27. In relation to agreements entered into in breach of product intervention rules, s. 137C(7) sets out that the rules may:

a) provide for a relevant agreement or obligation[22] to be unenforceable against any person or specified person;

b) provide for the recovery of any money or other property paid or transferred under a relevant agreement or obligation by any person or specified person;

c) provide for the payment of compensation for any loss sustained by any person or specified person as a result of paying or transferring any money or other property under a relevant agreement or obligation.

28. The unenforceability provision would only apply to sales made after the introduction of the rules and in contravention of those rules. Consumers holding products bought after the introduction of rules incorporating unenforceability provisions would generally need to seek redress through the usual channels of complaints to the firm and to the Financial Ombudsman Service, or legal action against the relevant firm. Such consumers would not, however, need to make their case for compensation beyond demonstrating that the agreement or arrangement was entered into after the relevant product intervention rule came into effect.

29. Arrangements made before the introduction of the rules would not be affected by the unenforceability and compensation provisions. Consumers holding contracts made before these rules were in place would still be able to seek redress through the usual channels of complaints to the firm and to the Financial Ombudsman Service or legal action against the relevant firm. These consumers would need to establish their claim to redress in the usual

22 'A relevant agreement or obligation' means:
a) a specified agreement;
b) an agreement entered into in contravention of any rule made as a result of paragraph 2.3 (c) or (d); and
c) an obligation to which a person is subject as a result of exercising a right conferred by an agreement within paragraph (a) or (b) of this footnote.

way, for example by demonstrating that the advice they received was unsuitable, or that they bought the product after receiving a misleading financial promotion.

Process for the making of temporary product intervention rules

30. Temporary product intervention rules will follow the process for high impact policy issues.

31. Once initial proposals have been discussed, a paper will be prepared at working group level for a committee (the Committee) with appropriate authority to propose temporary product intervention rules to the FCA Board.

Taking policy proposals to the Committee and the Board

32. The Committee will elect either of the Chief Executive Officer, a member of the Executive Committee or the Director of Conduct Policy to act as Chair at each meeting.

33. The Committee will either give the go-ahead to take the proposals to the Board, or suggest rethinking the proposals and coming back at a later date, a decision may be taken to use a different regulatory tool, or a decision will be taken not to proceed.

34. If the Committee decides to take the proposals to the Board, the paper will be taken to the monthly scheduled Board meeting, but if the matter is of great importance or there is an emergency, the Board may convene specifically to consider this issue.

35. If the Board makes a decision to act on the policy proposals, the temporary rules will be published on the FCA website and the necessary follow-up actions taken.

EU considerations

36. The potential scope of general product intervention rules is also being discussed at EU level and will likely become a regulatory feature of financial services regulation in the EU. Product intervention powers feature, for example, in the European Commission's recent proposal of the revised Markets in Financial Instruments Regulation.

37. The Committee and the FCA Board will consider how the national approach fits within the wider EU legislative framework in their discussions.

38. Where appropriate, the Committee and the Board will recommend consideration of the same issues at EU level.

Informing the Panels

39. There are three Panels: the Practitioner Panel, the Consumer Panel, and the Smaller Business Practitioner Panel. The Panels represent the interests of consumers and practitioners by advising, commenting and making recommendations on existing and

developing FCA policies and practices. We will generally seek their views during the rule-making process for temporary product intervention rules if there is sufficient time to do so.

Consulting the PRA

40. We will discuss any proposed product intervention rule (whether temporary or not) with the Prudential Regulation Authority (PRA) and give its comments due weight and consideration before making the rule.

Principles of Good Regulation[23]

41. As with any rule-making exercise, we will have regard to the principles of good regulation when making temporary product intervention rules. These principles include:

a) the need for the FCA to use its resources in the most efficient and economic way;

b) the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, which are expected to result from the imposition of that burden or restriction;

c) the general principle that consumers should take responsibility for their decisions;

d) the responsibilities of the senior management of persons subject to requirements imposed by or under FSMA, including those affecting consumers, in relation to compliance with those requirements;

e) the desirability in appropriate cases that the FCA publish information relating to persons on whom requirements are imposed by or under FSMA, or requiring such persons to publish information, as a means of contribution to the advancement of the FCA's objectives; and

f) the principle that the FCA should exercise its functions as transparently as possible.

42. As part of our consideration of issues including the desirability of facilitating innovation, we will consider the potential deterrent effect on entry and innovation when making temporary product intervention rules against the potential for reducing anticipated consumer detriment.

23 The Principles of Good Regulation as reflected in the current version of the Financial Services Bill. We will amend the Statement of Policy to reflect any amendments to the Bill.

Publication of temporary product intervention rules

43. We will publish a statement on our website explaining why we are introducing the rule. We may choose to invite feedback on this, but it will not amount to a consultation exercise.

Post-implementation review of temporary product intervention rules

44. We may choose to review a temporary product intervention rule during the term for which it is in force. Such a review will generally depend on the perceived risk the rule seeks to mitigate. These reviews may be informed by market monitoring and feedback from stakeholders, including product providers, distributors and consumers.

45. Where we perceive potential uncertainty about how the rule operates, we may consider publishing guidance.

46. Reviews are likely to consider whether a rule is functioning as intended, including whether:

a) there have been any breaches of the rule;

b) there are any unintended consequences, such as an impact on products that were not intended to be caught by the rule;

c) there is evidence suggesting firms are working around the rule rather than complying with it, for instance where new products enter the market or new features are added to existing products that expose customers to the same or similar potential detriment; or

d) new evidence demonstrates that the rule is not necessary or customer detriment is unlikely.

47. As a result of these reviews, where necessary, we may:

a) revoke a temporary product intervention rule; or

b) where a rule specifies certain criteria under which the sale of a product may continue, change these criteria.

48. Subsequent changes to a temporary product intervention rule will be communicated by issuing a new statement containing the revised rule and the rationale for the changes. Such changes will not extend the lifespan of the temporary product intervention rule.

49. However, we may consult on a new rule to replace the temporary product intervention rule from the date on which the temporary rule ceases to have effect. This exercise would be subject to our standard rule-making exercise, including market failure analysis, cost/benefit analysis and consultation to which all stakeholders, including providers, distributors and consumers would be invited to reply.

Annex 1

Market failure analysis

1. A number of market failures can lead to consumer detriment, and might warrant temporary product intervention rules. For the purposes of this analysis, they may be usefully categorised as information asymmetries, behavioural biases and market power. Combinations of these may also interact with each other and thus exacerbate the problems.

2. It should be noted that this market failure analysis (MFA) explains why the FCA should be able to make temporary product intervention rules. We are not trying to predict the circumstances in which the FCA will or will not choose to make individual rules, nor do we suggest that the presence of the drivers of market failure identified below will always mean that the FCA will make temporary product intervention rules.

Underlying drivers of market failure

Information asymmetries

3. Information asymmetry arises when one party to a transaction has more information about the transaction than the other. This is relevant for temporary product intervention rules because consumers of financial products are often at a disadvantage in terms of information, due to the intrinsic complexity of many financial products as well as the relative infrequency with which the average consumer is likely to buy financial products (for instance credence goods). For example, if the product is purchased rarely or as a one-off, then even dissatisfied consumers are not often in a position to exert competitive pressure on providers to offer good quality and good value products by exercising choice.

4. Information asymmetries may also decrease competition in the market, since consumers face difficulties in evaluating and comparing products or cannot do so effectively. Information asymmetries regarding product suitability and prices can also be utilised by firms to increase profits. Finally, products may be designed in such a way as to be inherently inappropriate or disadvantageous for most customers, and so as to exploit consumers' difficulty in evaluating complex propositions.

Behavioural biases

5. A variety of behavioural biases may also lead to poor consumer outcomes. These include:

a) Present bias, where consumers respond to urges for immediate gratification resulting in overvaluing the present over the future. Overconfident consumers, who may demonstrate self-control problems, may mis-estimate future use of a product or particular product features. Consumers' overconfidence can be exploited by shrouding, whereby firms use hidden charges or disadvantageous product features such that some consumers do not take them into account when evaluating financial products. Consumers may also procrastinate, or exhibit inertia, resulting in a lack of search for the best products, a lack of reassessment of whether the products they hold offer best value for money and switching if not and/or not cancelling products that they intend to cancel or should cancel. All of these decrease effective competition in the market since the product features which should be competed on are made less salient and consumers cannot compare products easily.

b) Reference dependence, which occurs when consumers assess the value of a product relative to a particular reference point, which may be misleading or lead the consumer to make choices which are not optimal given their circumstances and preferences. There is evidence that consumer choice can be unstable and vary depending on which reference point is chosen.

c) Loss aversion, which is a particular form of reference dependence, in which a dominant fear of losses may prevent consumers from making decisions which might benefit them. For example, loss aversion may lead to a preference for the status quo, distortions in attitude to risk and valuing a good more just because you own it.

d) Framing, where consumers may react differently to a choice situation (with possible poor outcomes) due to the way in which their decision is presented to them. Framing usually works by triggering a particular bias (such as loss aversion, reference dependence, regret, a rule of thumb), as certain information is made more salient and ensuring limited attention is paid to other facts. This affects how consumers evaluate the benefits of individual products and as a result consumers may not find the cheapest and most appropriate product for their needs.

e) Consumers' susceptibility to persuasion may also create biases. Emotions in social interactions are important: persuasive emotional arguments from a salesperson can cause consumers to be persuaded to buy a product that is not ideal for them, or consumers may trust the salesperson due to their expertise. This can result in consumers insufficiently accounting for the incentives of the information provider and making decisions on the basis of emotions, which may result in consumer detriment.

6. All of these biases, and others, can result in consumer detriment since they allow firms to sell complex products/complex pricing structures, charge inappropriately high exit fees and inappropriately market and sell products outside their target market, all of which exploit

consumers' behavioural biases and weaknesses. Exploitation of consumer behavioural biases may result in ineffective competition, since they can prevent product comparison, increase switching costs (or perceived costs) and reduce product transparency.

Market power

7. Market power can lead to higher prices and poorer quality in goods and services, with consumer detriment as the result. Market power may arise due to structural problems in the market, for example where potential entrants are deterred from entering the market, or from an inability or unwillingness of consumers to exercise competitive pressure on firms. In addition some business practices, such as tying, bundling or built-in product complexities, might lead consumers to purchase additional or perhaps unnecessary products. It may also have a negative impact on price transparency, comparability among providers and consumers' switching ability, leading to a decrease in competition.

Conflict of interest between firms and consumers

8. In some circumstances market mechanisms are unlikely to resolve these failures. One reason for this is that firms can directly benefit as a result of some of the market failures discussed above. For example, behavioural biases and information asymmetries may lead to consumers purchasing financial products which may not be appropriate for their needs, but which provide higher returns to firms. Furthermore, consumer detriment may arise even where there is the appearance of intensive competition; but competition takes place on irrelevant product features, as a result of behavioural biases. This can lead consumers to buy poor value products and/or expose consumers to excessive risk associated with the product.

9. Furthermore, it is evident from the observation of some sales practices that some firms actively embrace behavioural biases in order to increase profits. Information asymmetries regarding product suitability and prices can also be utilised by firms to extract greater profits from consumers, creating a direct conflict of interest between firms and consumers.

10. For example, firms might exploit consumers' loss aversion by increasing perceived switching costs, which make it difficult to reject the status quo, which will also decrease effective competition. Consumers' overconfidence might also incentivise firms to utilise 'shrouding' of hidden charges in such a manner that some consumers do not take them into account when buying financial products. This impairs effective competition in the market since the product features which may be relevant to consumers are made less salient and consumers cannot compare products easily.

11. Furthermore, in markets where consumers rely on the advice of intermediaries (for example, retail investment, mortgages or insurance), an adviser should act to reduce information asymmetry between the consumer and provider, enabling the consumer to purchase a more suitable product. However, intermediaries can have incentives to withhold

relevant information or use it to their own benefit and to the detriment of consumers. For example, if they are paid commission for sales and the amount varies among products, this may influence which products are sold, especially if the chance of an unsuitable sale being discovered is low.

The role of temporary product intervention rules

12. Potential solutions to the above market failures include promoting better financial education for consumers, enhanced disclosure requirements, introducing measures to tackle specific product-related issues and intervening to improve the effectiveness of competition so as to improve outcomes for consumers.

13. Where the FCA considers that urgent action is required to prevent the risk of significant consumer detriment, then temporary product intervention rules will form one regulatory tool which it may use in seeking to address or mitigate these risks. As with any other intervention or rule-making exercise, the FCA would generally seek to satisfy itself that market mechanisms are unlikely to correct the problem on their own, or are unlikely to do so within an appropriate timeframe.

Annex 2

Compatibility statement

1. This compatibility statement comments on the compatibility of our proposed Statement of Policy with the draft duties and objectives of the FCA, as set out in the Financial Services Bill.

The FCA's anticipated duties and regulatory principles under the Financial Services Bill's proposed amendments to FSMA

2. Section 138I(2)(d) of FSMA (as proposed by the Bill) requires that a consultation undertaken by the FCA includes an explanation of the FCA's reasons for believing that making the proposed rules is compatible with its duties. We comment on these below.

3. In carrying out its general functions, the FCA must, so far as is reasonably possible, act in a way that: (a) is compatible with its strategic objective; and (b) advances one or more of its operational objectives (section 1B(1) FSMA, as proposed to be amended by the Financial Services Bill).

4. While the draft Statement of Policy itself does not introduce any rules, it does set out the process the FCA proposes to follow when it considers making temporary product intervention rules. We believe the policy and approach covered by this CP is compatible with the FCA's operational objectives – particularly to secure an appropriate degree of protection for consumers, to promote effective competition in the interests of consumers.

5. In carrying out its general functions the FCA must have regard to the regulatory principles set out in FSMA (section 3B, as proposed to be amended by the Financial Services Bill).

6. We believe that the proposed approach documented in this CP is compatible with the draft regulatory principles, and in particular the need to use the resources of each regulator in the most efficient and economic way, and the principle that the regulators should exercise their functions as transparently as possible.

Annex 3

List of questions

Q1: Do you agree with our analysis of some of the circumstances in which temporary product intervention rules might be necessary?

Q2: In what other circumstances might it be necessary to make temporary product intervention rules?

Q3: Will our proposed approach create an appropriate level of awareness amongst firms affected by temporary product intervention rules?

Q4: How should the FCA balance the need for clarity and awareness in the market against the likely need for urgent action when making temporary product intervention rules?

Q5: How can the FCA best protect consumers who hold products which might be affected by temporary product intervention rules?

Q6: Do you agree with our analysis of how temporary product intervention rules might impact upon innovation and market entry?

Q7: What issues should we consider in relation to how this Statement of Policy affects equality and diversity?

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