

---

# Our response to key comments from the independent Panels' annual reports





# The Markets Panel

## Providing input into the FCA approach to wholesale and markets supervision

### Wholesale and markets supervision

The Panel was supportive of the FCA's planned proportionate approach to wholesale supervision, and welcomed the Memorandum of Understanding for coordination between the FCA, PRA and Bank of England in their oversight of the market. The Panel urged us to work particularly closely with firms in our supervision of market infrastructure, as they can help us oversee the markets. It is also keen to see us establish a clear regime and working relationship with our recognised bodies, such as exchanges, clearing providers and settlement systems, given their role in providing market stability

On 1 April 2013, responsibility for the supervision of Recognised Clearing Houses (RCHs) transferred from the FSA to the Bank of England and we took over responsibility for the supervision of Recognised Investment Exchanges (RIEs) and other trading venues.

As a result we refined and focused our supervisory approach for RIEs on key issues around market integrity and investor protection, such as operational resilience, effective systems and controls to identify and prevent abusive trading activity, and effective governance. This has involved greater focus on, and interaction with, the group holding companies that own, oversee and operate UK RIEs. We also published a policy statement in May 2014 looking into competition in the markets for services provided by RIEs.

To ensure the appropriate coordination across RIEs and RCHs, many of which are part of broader infrastructure groups, we have a memorandum of understanding (MoU) in place with the Bank of England and the Prudential Regulation Authority (PRA).

Our CEO and the Deputy Governor for Financial Stability of the Bank of England reviewed the arrangement for cooperation under the MoU including input from the Recognised Bodies. In March we published a statement confirming that they have worked well, and in a coordinated manner with no material duplication.

### Measuring performance

The Panel encouraged the use of 'market cleanliness' statistics to monitor how our market monitoring and enforcement deterrence was working. It suggested we could also look at other metrics, such as how our policy affects commonly traded financial instruments, to ensure we nurture thriving, efficient and effective markets that work well for their consumers.

We discuss how we measure our performance as an organisation in Chapter 1 of our annual report. Our market cleanliness statistics measure the scale of share price movements in the two days ahead of regulatory takeover announcements and identify movements that are abnormal compared to a stock's normal movement. We are pleased that the Panel values this work.

We will continue to use in-depth market studies to look at firms' behaviour and how our regulation can affect consumer outcomes and the health of particular financial markets. In 2014 we will undertake a review of competition issues in wholesale markets, with a view to identifying any suitable candidates for market studies.

More broadly, we have access to a wide range of data sources that we routinely use to inform our policy initiatives and, where possible, assess their impact

## **Enforcement effectiveness**

The Panel suggested that we should focus on deliberate breaches of the rulebook, rather than accidental or technical breaches. It also considered that our resources should be devoted to clarifying and simplifying rules to prevent technical breaches, as well as concentrating on catching those who deliberately breach the rules. This is particularly the case for smaller firms, where greater transparency and explanation of regulatory requirements was often needed, to help those without large compliance teams.

We are looking into how our Handbook rules are drafted and whether they could be made easier to understand and use.

We will continue to engage with all our stakeholders and seek to improve our processes wherever possible to ensure we are effective and transparent. For example, to ensure an effective transition for consumer credit firms from the Office of Fair Trading to the FCA we engaged with firms, trade bodies, consumer groups and the government.

We used a variety of methods to ensure that firms were aware of the transfer, what they needed to do, how they would be regulated from April 2014 onwards, and what we expected of them. This included letters, phonecalls, meetings, trade press articles, speeches at events across the UK, webinars, website content and press and radio advertising.

## **Supporting a strategic approach from the FCA on international engagement to ensure that markets function well**

### **International context**

It is important for the firms that the Panel represents that the UK maintains its leading position in global markets. The Panel recognised the challenges associated with cross border supervisory and regulatory developments and was concerned that we have spread responsibility for international work across a number of divisions to ensure appropriate knowledge and expertise. It believes it is vital for us to continue our commitment to international negotiations and to consider new strategies to maintain a strong position of influence, particularly in light of forthcoming European Parliamentary elections and a renewed European Commission during 2014.

We fully recognise the importance of our international work and the need for a coherent and consistent approach to our international engagement. Given the global nature of financial services regulation, staff from across a range of policy areas will be engaged in international negotiations, and other work at international level, at any one time.

### **UK growth agenda and competitiveness**

The Panel was pleased that we will consider some aspects of the competitiveness of UK markets by applying a robust, well designed and proportionate regulatory regime to all aspects of its work. However, it was concerned that the UK has been developing standards without in principle buy-in from contemporaries at a global level.

For example, the nature of asset management and trade execution services is such that by making arrangements more expensive or burdensome in the UK, activity may migrate to locations with different regulatory or supervisory standards. The Panel is concerned that this would be a loss to UK investors and the UK economy without any tangible improvement in supervisory or regulatory outcomes.

We welcome the Panel's support of our approach to the development of our regulatory regime. We seek to ensure that our rule-making remains proportionate and that the practical impacts have been considered carefully. However, to achieve our objectives, and often in light of the features of the UK market, we may need to apply rules on a national basis.

## **MiFID 2**

The Panel believes that a key challenge of MiFID 2 is the provision, cost and use of data. With firms already reporting transaction data under older requirements, and with recent changes to reporting in the derivatives market, the Panel was keen to stress that these should be brought together wherever possible to avoid duplication. For example, it suggested that exchanges and clearing houses could handle some of the submissions for their users, and possibly the FCA's own transaction recording system (Zen) could be used to meet MiFID 2 requirements on the regulator.

It also raised questions about the impact of MiFID requirements on the liquidity of trading in certain securities and financial instruments, encouraging us to look at international experience and for us and ESMA to conduct thorough cost-benefit analysis on all of its proposed requirements before taking action.

It asked that we allow sufficient time for firms to implement the requirements of MiFID 2, and provide an orderly plan and transition for firms.

We do and will continue to work closely in ESMA with other national regulators on market data issues.

In recognition of the challenges these issues pose, ESMA established in 2013 a Market Data Reporting Working Group (MDRWG) to: '... work on issues relating to reporting of transactions, positions, record-keeping of orders and instrument reference data.'. The MDRWG works on market data issues across different pieces of EU legislation so that, within the constraints of the relevant framework legislation, issues can be looked at together rather than separately.

Increasing transparency is a key objective of MiFID 2 and the G20 conclusions on the functioning of OTC derivative markets which it in part implements. However, the pre and post-trade transparency requirements in MiFID 2 are required to be calibrated in several ways, including in relation to the liquidity of financial instruments.

ESMA has hired external expertise to assist with the mandatory cost-benefit analysis it is required to include when submitting draft technical standards, which will include technical standards on transparency issues, to the European Commission.

Deadlines for the implementation of MiFID 2 are set by the framework legislation and not by the FCA.

## **Dealing Commission**

The Panel was overall supportive of our investigation into the use of dealing commission, although it urged us to consider the potential impacts, and explore the options for addressing perceived harm and consumer detriment, including stronger supervision and mandating greater clarity over investor charges. It also considered that we should seek to align any changes with the development of MiFID 2 requirements.

As we set out in October 2013 at our Asset Management Conference, our work on the use of dealing commission consists of two distinct workstreams:

1. Making more immediate clarifications and enhancements to our rules in response to the issues identified in our 2012 review of investment managers' conflicts of interest in this area.
2. Launching a wider review of the regime to consider whether more fundamental reform is needed in the medium term. This involved a thematic supervisory review of buy side and sell side firms, and industry roundtable discussions on the use of dealing commissions and the market for funding research. The wider review seeks to inform parallel EU discussions on reforms to MiFID that may bring fundamental structural change in this area by early 2017.

CP13/17 and PS14/7 were designed to deliver immediate improvements to the clarity of our rules and ability to supervise them effectively, while not ruling out further reform.

We are aiming to publish an update on the wider review, feeding back on the findings of our supervisory work and discussions with stakeholders, and considering the case for more structural reform in the context of developments in EU discussions on MiFID 2.

We welcome the Panel's input on this next stage of work in due course.

### **Parliamentary Commission on Banking Standards (PCBS)**

The Panel highlighted the possibility of unintended consequences of a wider application of the PCBS changes to non-bank financial services providers, such as those represented by the Panel. The Panel encouraged us to take a proportionate approach to implementing the recommendations set out by the PCBS, which could otherwise create undue burden and impact on innovation and provision of good services to customers.

We will work with the Prudential Regulation Authority (PRA) to implement the majority of recommendations made by the PCBS, including those introduced in the Financial Services (Banking Reform) Act 2013. This legislation introduces the new Senior Managers and Certified Persons Regimes for deposit takers and the nine PRA investment firms. We will consult on these new regimes in 2014.

We agree with the PCBS that individual accountability should be enhanced and risks and rewards in banking better aligned.

We will also consider the potential application of the PCBS recommendation to non-deposit takers in due course once we have learned lessons from the regime for deposit takers.

### **Identifying risks in the markets**

#### **Perimeter risks**

The Panel suggested that we take a careful and proportionate approach towards crowdfunding platforms, which we have regulated since 1 April 2014 as part of our consumer credit remit.

It also suggested that we should monitor the rise of 'crypto-currencies' such as Bitcoin, as an investment asset. This market is currently unregulated, although many investors use Bitcoin as such an asset.

We have sought to develop an appropriate and proportionate regulatory framework for crowdfunding platforms, to guard against the risks of investing in or lending to start-up businesses.

We continue to monitor the market to check that adequate standards are maintained. We plan to review the implementation of the new and revised rules by the end of this year, and to carry out a full post-implementation review of the market and regulatory framework in 2016 to identify whether further regulatory intervention is required.

### **Market abuse work**

The Panel encouraged us to be clear and proportionate about our market abuse requirements, by dedicating more resources to tackling serious and intentional breaches, rather than more minor and technical failings. It questioned whether we focus sufficient, equal attention across all the different markets.

Our risk-based approach means that not every matter where a possible breach has been identified will be suitable for investigation. Nevertheless, all firms should understand that breaches of rules can have a real impact on markets or on our ability to meet its statutory objectives (for example, failure to report transactions correctly can have an impact on our ability to tackle market abuse, as shown by our action against RBS in 2013).

We are committed to tackling serious breaches, for example we have recently fined Barclays Bank £26m for failing to adequately manage conflicts of interest between itself and its customers, as well as system and control failings, in relation to the Gold Fixing.

We banned and fined Daniel Plunkett from trading, and we took action against Mark Stevenson, a bond trader, who was banned and fined for deliberately manipulating the UK Gilts market.

We will continue to take appropriate and proportionate action to promote high standards of market conduct and to deter people from committing misconduct in the future.

### **FCA Business plan and competition in markets**

With regard to our planned Wholesale Strategic Review and Market Study, the Panel felt it was important for us to explore with industry where potential competition issues may exist, and which caused greatest concerns or could be most easily remedied, before starting a full market study. The Panel urged us to define the types of detriment we need to tackle, and be clear about the types of intervention in the market we consider to be appropriate as part of our Wholesale Strategic Review Market Study. Modern wholesale markets are complicated and often interconnected with other markets, so the Panel encouraged us to seek to understand the full reason why arrangements appear as they do.

It also highlighted the difficulty of defining the boundaries of the market, as many wholesale markets operate for the benefit of and with input from non-UK participants, with London competing against other financial centres. This will pose challenges if we choose to impose any structural remedies to address issues.

As set out in our Business Plan 2014/15, we will make an initial assessment of competition issues in wholesale markets as part of a competition review of the wholesale sector, identifying any potential candidates for markets studies.

We published an initial call for inputs by October 2014 and have taken on board the Panel's comments in putting together our consultation document. We welcome the Panel's ongoing engagement with this work and would value the Panels' views on which areas of the industry carry potential competition issues.

## **CASS review**

The Panel was supportive of the proposals arising from our CASS review, and considered that they addressed many of the issues identified in recent insolvency cases. The Panel also welcomed the fact that we are working closely with the Treasury, given that our CASS regime interacts with the Special Administration Regime created by Government legislation. However, it felt more work is needed to improve the speed of return and ensure the outcomes for clients are predictable.

We acknowledge that more work needs to be carried out to improve the speed of return and ensure the outcomes for clients are predictable in the event of a firm failure. However, we have made significant improvements to the regime in PS14/9, which will improve the speed of return of client money and custody assets to clients once the rules come into force over 2014/15.

We are currently reviewing the client money distribution rules with a view to consulting on changes later this year, which together with the Treasury's work on the independent reviewer's recommendations to improve the Special Administration Regime, should further improve this.

The changes we can make are limited to those within our jurisdiction. The Treasury's response to the recommendations and subsequent changes to legislation should provide the legislative framework to ensure that the best outcomes for clients are achieved in the event of firm failure.



# The Practitioner Panel

## The FCA as an effective regulator

### Constructive and judgement-based approach

The Panel encouraged the FCA to set out a clear long-term vision for regulation which would foster a well-functioning competitive market place for consumers and a successful, thriving industry for firms.

It is concerned about the consistency of our approach and knowledge of the industry between senior management and more junior staff on the ground. Firms' concerns over the level of experience and knowledge among supervisors. It supports the development of a firm-FCA secondment programme.

We aim to maintain a successful financial system, where firms can thrive and consumers can place their trust in transparent and open markets. Our *Business Plan 2014/15*<sup>1</sup> sets out how we will shape our activities, integrate new responsibilities, implement and improve our models and systems, develop our people and ensure that our priorities remain focused on achieving our objectives.

In the last year we have had a complete review of our learning & development approach for Supervision staff. This has led to the creation of learning pathways at both the foundation and intermediate levels that are focused on increasing our capability. As per the FCA's people strategy, the recent launch of the FCA Academy and its associated MSc programme is another example of us focusing on professional development and raising our capability.

Earlier this year we reached agreement with a number of Practitioner Panel firms to a formal secondment programme that will see both FCA and firm staff gaining practical experience and knowledge. We believe that these and other initiatives show that we are taking seriously the need to ensure the right level of capability and engagement with firms.

### Value for money

The Panel urged us to consider the total cost of regulation and ensure robust cost benefit analysis is undertaken before actions are taken or new policy developed. Compliance costs are ultimately borne by consumers and can lead to a reduction in innovation and service levels, as well as a drag on the growth of the UK economy.

We appreciate the need to consider firms' costs in addition to our own when we develop new policy or undertake new actions. This need is embedded in our proportionality principle of good regulation, which states that any burden or restriction we impose on a person or activity should be proportionate to the benefits which are expected as a result.

We consult on our fees annually before stating our final policy. In making judgements in this area, we take into account the costs to firms and consumers of complying with any new burden or restriction. One of the main techniques we use is cost benefit analysis of proposed regulatory requirements.

In relation to our own internal budgets we are currently modelling our options for 2015/16 to 2017/18. We are keen to keep any ongoing running cost increases to a minimum and we will bear this in mind as we go through the budget-setting process.

<sup>1</sup> <http://www.fca.org.uk/news/about-us/business-plan-2014-15>

We are facing significant possible future cost pressures from the European Regulatory Agenda in relation to MiFID and other data-intensive European Directives. We are seeking to mitigate these by collaborating with the other European regulatory bodies.

### **Success measures**

The Panel has questioned us about how we will measure our success, particularly as it believes our three operational objectives can create some tension, with more resources potentially spent on consumer protection than competition.

It encouraged us to commit to positive measures indicating good consumer outcomes, rather than negative measures indicating our own success. It was also concerned about us using any measurement of pricing, given that we are not a pricing regulator.

Accountability and transparency are fundamental to how we work, and a key part of this is how we measure performance and success, and report on our achievements. We have developed an outcomes-based performance framework made up of four elements designed to measure different aspects of our performance. Our framework breaks down our statutory objectives into long-term outcomes that we would like to see in the industry, indicators of these outcomes and performance measures, acknowledging that the FCA is only an enabler.

Our use of price measurement in performance measures is limited. We do not consider a reduction in prices to be an outcome we necessarily seek to achieve as an end in itself. However, prices can be indicative of value for money products and services, and price dispersion can be an indication of competition working well or not so well in the interests of consumers in a specific market. So, where applicable, we use information on pricing and price dispersion as a proxy for effective competition.

### **Consumer credit regulation**

The Panel highlighted a concern about pressure on our capacity to absorb the new responsibilities, as well as any potential for unintended consequences as we introduced our new consumer credit regime.

For example, in applying the Consumer Credit Act (CCA) to general insurance premiums paid in instalments, the Panel urged us to adopt a pragmatic approach by using the same approach as previously applied by the OFT and use guidance rather than rules.

Our ability to absorb these new responsibilities has been helped by the transfer of 100 OFT staff to the FCA, whose knowledge and expertise helps us to make informed judgements and decisions. We carried out research into the consumer credit market and consumer dynamics, which helped inform our plans for the first year. To resource the high volume of firm applications from October 2014 we are working with an external provider to give us the flexibility to respond to peaks and troughs in volumes.

Where the payment of insurance premiums by instalments constitutes a regulated credit agreement, this is unchanged by the change of regulator, and the residual Consumer Credit Act (CCA) requirements – including around pre-contract information and credit agreements – continue to apply.

In designing our conduct of business rules, we have sought to build on issues of proportionality embedded in the Office of Fair Trading's Irresponsible Lending Guidance. For example, in our policy statement 14/3, we note that the extent and scope of an assessment of affordability should be dependent on and proportionate to relevant factors, and that firms should consider what is appropriate based on, for example, the type and amount of credit and the risks to the consumer.

More generally, we have carried across a number of CCA provisions and OFT guidance in the same, or substantially the same, form as previously. Firms that were complying with the previous regime were unlikely therefore to need to change their behaviour significantly.

## **Strategic impact of regulation**

### **Constructive tone from the FCA**

The Panel emphasised the importance of our overall tone of voice in setting a constructive regulatory agenda. Greater awareness and transparency around expectations and developments is welcome, but our communications need to be balanced and constructive, especially when delivered directly to the press or consumers.

We have worked closely with the Panels to inform our communications approach. We aim to deliver communications in a clear, consistent and constructive tone – so that external stakeholders know what we expect and are aware of issues that may affect them. We will continue to seek to ensure our external communications are consistent effective and achieve their desired purpose.

### **Enforcement as credible deterrence**

The Panel welcomed our evaluation of how enforcement can be most effective, including promoting the credible deterrence message. However, the Panel expressed concern about the wider impact of our new power to publicise enforcement warning notices. We emphasised that there is a delicate balance between the need to be transparent and the undermining of trust in individual firms and the industry more generally.

We were given the power to publish information about enforcement warning notices by the Financial Services Act 2012. In determining how to use this power we took the views of the Panel and other stakeholders into account.

Our policy, which came into effect in October 2013, strikes a balance between promoting the early transparency of enforcement proceedings and limiting the risk that publication will cause harm to the subject of the warning notice.

We will consider the circumstances of each case, but will usually consider it appropriate to publish a warning notice statement, which will set out a brief summary of the facts that gave rise to the warning notice to enable consumers, firms and market users to understand the nature of our concerns. The warning notice statement will usually name the firm under investigation, but only in certain circumstances will an individual be named. The final decision will usually be made by the Regulatory Decisions Committee (RDC) chairman, who will first consult the person under investigation and take into account any evidence they provide that publication would be unfair.

By the end of May 2014, we had published 10 warning notice statements. All of these related to warning notices given to individuals, none of whom were named in the warning notice statements.

### **Competition and market studies**

The Panel was disappointed that it was not given the opportunity to provide context and understanding on areas for investigation before our market studies began.

In particular, it felt that it was the wrong time to look at the cash savings market, as

currently the market is affected by a host of unique and potentially distorting influences. It warned us against focusing on price alone. For example, the quality and reputation of an institution can be equally influential.

The Panel suggested that we should take a broad perspective on our approach to competition, including considering the impact of regulation and our own actions.

We identify potential areas for market studies using information from a range of sources, such as our own intelligence, past studies, internal papers and analyses, super-complaints, market intelligence and complaints and information from third parties, as well as the Panels.

We agree that it is important to ensure that any announcement of a market study does not speculate on the functioning of that market prematurely. We are satisfied that our announcement of the cash savings study was neutral and balanced, and drew no conclusions in relation to how well the market functions.

We note the Panels' observations about the low interest rate environment and the Funding for Lending Scheme. We took these issues into account when deciding whether to launch the study, and we have been mindful of both factors as we gather information and undertake our analysis.

We would welcome the Panel's thoughts on which areas would be suitable candidates for market studies and we are doing more to ensure this dialogue takes place regularly.

### **Parliamentary Commission on Banking Standards (PCBS)**

The Panel emphasised that there must be proportionality in the way we approach and consider the Parliamentary Commission Banking Standards recommendations, as the measures could lead to a 'blame culture' and potential criminal liability putting off the 'best and brightest' from joining the industry. It advocated a constructive and proportionate approach and suggested that senior managers' responsibilities might be fairer if applied broadly across all industry sectors, not just banking.

We will work with the Prudential Regulation Authority (PRA) to implement the majority of recommendations made by the PCBS, including those introduced in the Financial Services (Banking Reform) Act 2013. This legislation introduces the new Senior Managers and Certified Persons Regimes for deposit takers and the nine PRA investment firms only. We will consult on these new regimes in 2014.

We agree with the PCBS that individual accountability should be enhanced and risks and rewards in banking better aligned. The new regimes are not designed to lead to a 'blame culture' or deter good candidates from senior roles in financial services. We believe our consultation is a proportionate response to implementing these recommendations.

### **Impact of regulation on the financial advice market**

The Panel is concerned about the implications of the fall in the number of advisers at large high-street banking institutions, and financial advisers overall as the RDR came into effect. It considers that this could indicate a risk of an 'advice gap' with some customers unable or disinclined to receive appropriate advice.

The question of whether people who want to have access to advice do is often over-simplified, with claims that there is an advice gap created solely by the Retail Distribution Review (RDR). It is however a complex issue and to some extent it may actually be an investment gap or even a savings gap due to disposable incomes being stretched.

## **Balance of firm and consumer responsibility**

### **Consumer responsibility report**

The Panel has published the results of research commissioned by them, looking at perceptions of consumer responsibility among consumers and firms, and discussed them with us. The research should contribute to our expectations gap work, and the Panel looks forward to us further clarifying our position on consumer responsibility.

Over the last year we have carried out a piece of work exploring firms' understanding of our expectations of them. In particular we considered whether there was a gap between what we expect of firms, what firms believe we expect of them and, if there was a gap, the impact on firms' behaviour. The Practitioner Panel research fed into this process and provided some helpful insights in determining what future work was necessary.

Overall, we found that firms were broadly clear on our expectations but that there were a number of areas where we could do more to help firms and provide greater clarity. These included clarifying our expectations around non-advised sales, automated advice and focused advice processes. Also, giving firms more confidence to produce better disclosure material and clarifying the status of different forms of guidance.

Subsequently, we have held a series of workshops with firms and we are consulting on the different advice and non-advice sales processes with the aim of providing greater clarity for firms. We also plan to consult on proposals to improve disclosure and we have launched Project Innovate to help firms seeking to develop new ideas or business models that do not necessarily fit the current rule book but would genuinely benefit consumers.

## **FCA engagement with and implementation of EU rules**

### **Engagement with EU and international standard setters**

The Panel urged us to ensure that we have a clear strategy and commitment to proactive engagement in Europe given the increasing influence of Europe on our conduct agenda, ensuring European regulation is not unduly onerous on UK firms, but also does not contradict existing UK regulation.

We fully recognise the importance of the EU financial services agenda and agree that we, alongside HM Treasury and other UK authorities, must remain fully and constructively engaged in the European legislative processes. We coordinate the positions and strategies taken in European groups and European negotiations on all major issues where there is a shared interest to ensure a clear position.

We work closely with HM Treasury, which has lead responsibility for negotiating and agreeing 'Level One' Directives and Regulations. At this stage, we generally act in an advisory capacity. The European Supervisory Authorities (ESAs), such as the European Securities & Markets Authority (ESMA), are responsible for developing and advising on more detailed regulation ('Level Two', such as technical standards) designed to ensure consistent application of Level One legislation. We work very actively in the ESAs, alongside the PRA.

A key objective in all of our work in developing technical standards will be on ensuring that the European rules deliver on our statutory objectives, are proportionate, produced with consideration of the impact on firms and do not contradict existing UK rules.

## **Treasury Balance of competences on financial services**

The Panel submitted evidence to the Treasury's Call for Evidence in October 2013 on the balance of competences between the UK and the EU on financial services and the free movement of capital in the Single Market.

It was supportive of high-quality regulation, whether created at EU level or domestically, provided it is effective, proportionate, and designed to balance the competing objectives of financial stability, growth, consumer protection and a competitive market.

However, it highlighted a concern that retail consumers are not homogeneous across the EU, and some rules should be left to national level to achieve the best outcome. It also reported a certain amount of 'change fatigue' within financial services firms because of the vast amount of reform emanating from Brussels in a relatively short space of time.

We agree with the Panel that regulation should be effective, proportionate and designed to achieve clear objectives. We consider carefully the practical impact that all regulations have on firms, large and small. We agree that retail markets are diverse and a one-size-fits-all approach is unlikely to be appropriate in all cases. These considerations guide our approach to policy making at international, European and domestic levels.

# The Smaller Business Practitioner Panel

## Proportionality

### Supervisory approach

The Panel supports the proportionate and effective concepts behind our new supervisory system. Key to this will be ensuring that our staff are sufficiently knowledgeable about the businesses they are overseeing, and understand that smaller firms do not have the same compliance and system resources as larger firms.

It emphasised that many smaller firms use external compliance consultants and purchase 'off the shelf' reporting packages to meet data requests. So we should speak to these external providers to ensure that their packages reflect any changes in requirements and the regulated firms are not caught out.

We are currently considering our data strategy, which will look at how we adapt our reporting requirements to accept information provided through standard reporting packages. We also publish technical specifications and updates on our website specifically to help Independent Software Vendors (ISVs) keep up-to-date with our reporting requirements.

### Costs and burden of regulation

The Panel emphasised the need to consider the burden of regulation imposed on firms. However, it is alert to any signs that we may be moving direct costs (and fee levies) into indirect costs for regulated firms.

It has made suggestions about how we can manage costs to firms of skilled persons reports under section 166 of the Financial Services and Markets Act 2000, and it will continue to monitor how they are used.

The Panel has also asked us to check the proportionality of our increasing use of attestations over 2013/14 for both for large and small firms. It emphasised that there needs to be proper controls around how they are used, such as through principles including precise definitions of individual obligations and time limits.

We appreciate the need to consider firms' costs in addition to our own when we develop new policy or undertake new actions. This need is embedded in our proportionality principle of good regulation, which states that any burden or restriction we impose on a person or activity should be proportionate to the benefits which are expected as a result.

We consult on our fees annually before stating our final policy. In making judgements in this area, we take into account the costs to firms and consumers of complying with any new burden or restriction. One of the main techniques we use is cost benefit analysis of proposed regulatory requirements.

We are looking at how we use attestations as a formal tool, and we will make changes where we consider it necessary.

## Regulatory certainty

### RDR – thematic work and future compliance communications

The Panel is supportive of the principles of the RDR, but has highlighted where firms feel there is a lack of certainty regarding the practicalities of implementation, in particular

ensuring compliance with the definition of independent advice.

For example, there is a lack of clarity on how advisers could use product provider 'panels' to meet the 'whole of market' requirement of providing an independent service. There are also questions around the extent to which advisers must do due diligence on all potential products that might be suitable for the investor, whether it is the firm or individual who is 'independent', and whether an individual must be personally knowledgeable about all possible retail investment products.

We have been engaging in ongoing discussions with the industry to understand how firms have responded to the requirements we published in 2012, and we are providing support where necessary. One of the key themes coming out of these discussions is in relation to the practicalities of meeting the new independence requirements.

In response we published a thematic review, including examples of good and poor practice and further clarification on the specific topics highlighted above. We also produced a video (available on our website) setting out the requirements and our expectation of firms on disclosure.

We will revisit RDR as part of the post-implementation review in 2014.

### **Expectations gap and retrospective regulation**

The Panel highlighted concern in the industry that certain conduct or industry practice deemed acceptable today would later be viewed negatively and result in action against firms and individuals. It agreed that regulatory uncertainty is generally not good for anyone, and that we could help by ensuring rules and expectations are as clear as possible, providing guidance where possible.

Over the last year we have carried out work to explore firms' understanding of our expectations. In particular we considered whether there was a gap between what we expect of firms, what firms believe we expect of them and, if there was a gap, the impact on firms' behaviour. This included asking for examples of where firms believed we had taken retrospective action – judging practices on the standards of today rather than when the service was provided.

Overall, while we found some areas where greater clarity of our expectations would be beneficial to firms, we did not find any examples of action having been taken retrospectively.

However, we agree with the Panel that clarity is important for firms and, as a result of this work, we are consulting on the different advice and non-advice sales processes to provide greater clarity for firms on what is and is not possible under our rules, and where the tipping point lies between guidance and advice. We have consulted on proposals to improve disclosure and we have also launched Project Innovate to help firms seeking to develop new ideas or business models that do not necessarily fit the current rule book but would genuinely benefit consumers.

### **With-profits**

The Panel continued to press for clarity and resolution about our stance on with-profit funds. Without clarity, firms may not have been able to manage their obligations and liabilities to their consumers, and have faced uncertainty over their investment and capital positions. This may only be clarified once there is a legal test case on the rules.

There has been a long running debate on the future of with-profits mutuals and what should happen when their with-profits business goes into run off.



The new initiative adopted in policy statement 14/5<sup>2</sup> is an option to apply for a modification to the rules in COBS 20 and elsewhere to allow the firm to identify a mutual member fund that would not have to run off from the remaining with-profits element of the fund. We met members of the Panels before we published our policy statement in March 2014, and took their comments into account.

When we receive applications under this initiative we will continue to brief the Panels as appropriate and the Consumer Panel in particular has asked to remain informed.

## **Effective communication**

### **FCA Communication with smaller firms**

The Panel highlighted how vital it was for the FCA to communicate effectively with smaller firms. They were pleased with our increased willingness to engage effectively with industry this year.

This is a key deliverable for us in the coming year and we will take the learnings from our communication and engagements on consumer credit as a model, plus test and learn other methods and channels that are most effective for these firms.

In the meantime, we revamped our monthly email newsletter, Regulation round-up, to make it a quicker and more effective read. It still summarises key regulatory news by sector – so smaller firms can quickly find the content relevant to them – but now explores particular issues in more detail to give firms more insight into particular issues and highlights which items are ‘for action’, making it easier for firms to see what they may need to do.

### **Digital communication strategy for the FCA**

The Panel was pleased that we commissioned a review of our digital engagement strategy, and has provided input. It encouraged us to use tools such as ‘webinars’ more, as well as other digital media, such as podcasts and mobile phone apps.

We have been conducting a review to provide a clear strategic direction for our digital channels and to use digital to help us achieve our communications objective. A key part of this is evaluating how we can best serve our smaller firm stakeholders online.

We have greatly appreciated the interest and support of the Panel and its members have shown during our research phase, including taking part in our workshop sessions to further understand how firms use our website. We look forward to sharing further developments as we shape and rollout the strategy.

## **Awareness of risks in smaller firm community**

### **FCA Risk Outlook**

The Panel was consulted early in the development of our Risk Outlook and highlighted concerns regarding post-RDR charging structures, the falling value of long dated gilts and the possibility of consumers being misled by quick, online-only advice offerings. It encouraged us to provide context and explain the likelihood of the risk occurring, which

---

<sup>2</sup> <http://www.fca.org.uk/news/ps14-05-response-to-cp12-38>

would limit the potential for the Risk Outlook itself to damage consumer confidence.

We considered the Panel's comments on the Risk Outlook alongside comments received from key external and internal stakeholders. The document reflected the changing dynamics in the advice markets and the role that we have played in these changes.

We referred to the Retail Distribution Review (RDR) and its impact on the market and consumers in Chapter 2 of the Risk Outlook, through discussing technological developments and the policy and regulatory environment. Risks relating to these changes were included in Part B and were referenced in the cross-cutting risk that 'firms may focus on desirable business leading to reduced access for some consumer groups'.

### **Consumer and markets intelligence (CMI)**

The Panel has been very supportive of our CMI initiative and has suggested a clearer method for feeding these risks into our Risk Outlook and Business Plan.

We have had several valuable interactions with the Panel and we encourage it to continue to raise issues with CMI. We have noted the Panel's comments on how they can feed risks in to the Risk Outlook and Business Plan.

### **Compliance staff in smaller firms**

The Panel emphasised that many technical breaches of rules are unintentional rather than purposeful, for example because small firms often struggle to hire trained, experienced and knowledgeable compliance staff at a reasonable cost. The Panel has asked us to take into account the environment in which smaller firms are operating so that we can tailor rules and communications appropriately.

When dealing with events for smaller firms, we have to apply the applicable rules, but we endeavour to ensure they are applied in a proportionate way.

In all of our communications with smaller firms we aim to give clear messages to explain why firms have breached rules, what it means and what action we need them to take. We intend for our communications to be audience-focused, engaging, constructive and transparent.

### **RDR impact on independence**

The Panel has highlighted the risk to our objectives if independent advice is cut back and consumers can only opt for restricted advisers. These advisers may be restricted for a variety of reasons and this may confuse consumers as to the type of advice service they will receive from these firms. It has also debated the possibility of an emerging 'advice gap' caused by a trend of reducing numbers of financial advisers in the market.

It is true that the term 'restricted' can embody a wide range of different services and business models. We believe that firms should clearly disclose the nature of their restriction in a way that can be easily understood by consumers, and assessing the clarity of this explanation has been part of our thematic review.

### **Consumer credit**

We have been keen to see how the FCA has planned to address the challenges of authorising and supervising around 50,000 consumer credit firms, many of which are small firms. It was concerned it will place an additional burden on effective supervision and our Contact Centre to manage increased volumes.

All firms that registered for interim permission will be asked to apply for authorisation over the next two years. We have taken on staff from the OFT who have experience in dealing with firms that were previously licensed. To resource the high volume of firm applications from October 2014 we are also working with an external provider to give us the flexibility to respond to peaks and troughs in volumes.

Our processes are tailored to the level of risk that firms pose to consumers, so although this will not always be the case, many smaller firms may need to provide less information than others. We have expanded our contact centre to deal with the higher volumes and have recruited and trained our people to be able to deal with the increased calls we are likely to receive.

We outlined our approach to maintaining effective supervision in policy statement 14/3, *Detailed rules for the FCA regime for consumer credit*. We are initially delivering a supervisory approach to consumer credit firms built on firm-specific visits to the largest firms in certain sectors (including debt management, debt collection, home-collected credit, high-cost short-term credit, pawnbrokers and credit card issuers). We are also responding to and dealing with events, and conducting targeted thematic work, initially assessing the quality of advice in the debt management sector and the forbearance practices of payday lenders.

We are also regularly engaging with the main trade associations to build relationships, and tap into potential intelligence sources and data feeds, as well as get messages out to a population which is largely made up of smaller firms.

### **Mortgage Market Review (MMR)**

The Panel has urged us to be proportionate in our response to firms who struggle with some of the operational issues in implementing the MMR. It has also highlighted a potential for tensions to occur between PRA prudential requirements on lending criteria and our conduct requirements on providing access to the full range of mortgage products for the majority of customers.

We expect a period of adjustment to the MMR and will start formal testing in due course.

We are conscious that there is the potential for tensions between us and the PRA given our differing objectives, including in relation to the mortgage market. We are committed to working with the PRA to find workable solutions to any perceived or actual tensions for the industry or consumers, where this is possible.

### **Suitable approach to competition for each market**

#### **FCA competition powers**

The Panel encouraged us to set out our vision for the markets we are investigating and be bold with our new competition powers. It has suggested that there may be merit in looking at the competitive environment in connected markets outside of the regulatory perimeter. For example, a large number of small firms use external IT service providers and software packages to help with regulatory reporting.

We have a competition objective to promote effective competition in the interests of consumers in financial services. If we conclude that competition is not working well and we need to take action, we can intervene to promote effective competition using a number of measures, such as making rules or taking action against firms. However, such measures can only be applied to firms that fall within our regulatory perimeter.

If we identify issues where the root cause lies outside the scope of our regulation, we will liaise with the Competition and Markets Authority (CMA).

Since April 2013 we have undertaken a significant programme of competition work, including making progress in market studies into general insurance add-ons, cash savings, retirement income and working with the CMA on SME banking. When we launch a market study we set out in the terms of reference the issues that concern us, the potential adverse effects on competition and what we think the reasons behind them might be.

### **Cash savings market study**

The Panel felt that the timing of our first market study into cash-savings was unusual, as central bank and commercial interest rates were at historic lows, and the Bank of England was taking measures to provide funding for banks (through Quantitative Easing and Funding for Lending).

It was concerned about the publicity around the initial announcement of the study and the resulting negative press reaction towards industry and suggested that future announcements of market studies – and their results – could try to show a more constructive dialogue between us and industry.

We identify potential areas for market studies using information from a range of sources, such as our own intelligence, past studies, internal papers and analyses, super-complaints, market intelligence and complaints and information from third parties, as well as the Panels.

We agree that it is important to ensure that any announcement of a market study does not speculate on the functioning of that market prematurely. We are satisfied that our announcement of the cash savings study was neutral and balanced, and drew no conclusions in relation to how well the market functions.

We note the Panels' observations in relation to the low interest rate environment and the Funding for Lending Scheme. These issues were taken into account when deciding whether to launch the study, and we have been mindful of both factors as we gather information and undertake our analysis.

### **Annuities**

The Panel encouraged us to consider our wider behavioural economics work, and to bear in mind the realities for real-world consumers in the annuities market instead of assuming rational and profit maximising individuals.

It also pointed out that we should consider the underlying realities of the level of under-saving and investment during the accumulation stage of pensions. As well as studying the point of sale of the annuity, the Panels feel we need to work with the Money Advice Service and other consumer education bodies to encourage greater saving.

The market study into retirement income will explore measures to improve shopping around, and investigate other aspects of the market that did not seem to be working well. The revised terms of reference of this study can be found on our website.

One aspect of this work is to assess the extent to which there are features of the current market where competition may not be working effectively and in the interests of consumers. This will involve examining a number of issues, including product distribution, the role of advice and guidance, consumer decision-making and the

effectiveness of the open market option. We are also carrying out research to try to better understand the behaviour of consumers in this market.

Alongside this study is our review of pension providers' retention strategies and sales techniques when selling annuities to their existing customers. Through this we hope to pick up on any issues, for example regarding shopping around or the open market option, we will work with firms to address these. The good and poor practice that we identify will feed in to the market study and form part of the evidence-base for the development of the guidance guarantee.

## **Appropriate balance between firm and consumer responsibility**

### **Money Advice Service (MAS)**

The Panel has noted their concern about both the effectiveness of MAS and the size and source of funding for activities. While the provision of debt advice and counselling appeared sufficiently clear in its scope, success measures and outcomes, the provision of money advice was not.

It also spoke with the National Audit Office (NAO) during the year about their value for money study of the MAS, which drew similar conclusions about the cost and effectiveness of the service. It is pleased that the Treasury is reviewing the service.

We agreed and approved the Money Advice Service's key measures for 2013/14, which it met and in many cases exceeded.

During the year the Money Advice Service had more than 16.5 million customer contacts. It has very high customer satisfaction levels, with 90% of customers saying they would recommend it to others, and 92% that they would revisit it themselves.

The National Audit Office found that the Money Advice Service was delivering value for money in debt advice, and moving in the right direction on money advice.

## **Strategic approach to EU policy-making and implementation**

### **Response to the Treasury's balance of competence review**

The Panel believes that EU membership and the creation of a single market, including the UK, has broadly benefited financial services, but that regulatory costs for smaller firms are significant.

This means that, for many small firms, the costs of EU rules tend to outweigh the benefits in terms of encouraging new customers through granting protections, creating market stability or developing new opportunities for trade. Smaller firms also struggle to engage in the policy making process, so the views of smaller firms are not always reflected in final rules.

We are a key negotiating party for the UK, and the Panel believes there is a way to go to ensure smaller firms' views are considered in international discussions.

We agree with the Panel that regulation should be effective, proportionate and designed to achieve clear objectives.

We consider carefully the practical impact that all regulations have on firms, large and small. We agree that retail markets are diverse and a one-size-fits-all approach is unlikely to be appropriate in all cases. These considerations guide our approach to policy making at international, European and domestic levels.

## **Effective FCA and PRA coordination for dual-regulated firms**

### **Supervisory and policy coordination**

The Panel have encouraged us to ensure that supervision and supervisory visits to smaller dual-regulated firms are coordinated. The Panel understands that full coordination is not possible because of the complexity and number of firms that must be supervised, we have welcomed consideration of this. Equally, the request for the same data by two different regulators from a firm was flagged as being wasteful by the Panel.

There is a cross representation from the PRA and FCA on our respective information governance boards and we have a Joint Data Management Committee, which is established to oversee the functioning of our data sharing arrangements and reduce the burden of duplicate requests on firms.

## **The Consumer Panel**

### **The regulatory and policy environment**

#### **Consumer Rights Bill**

The Panel called for three amendments to the Consumer Rights Bill, taking into account some of the particular disadvantages experienced by consumers of financial services. It asked for a tailored exemption from the fairness test, a clearer definition of 'average consumer' and the right to cancel for 'mortgage prisoners'.

The Consumer Rights Bill is a piece of general legislation aimed at updating and codifying consumer rights covering contracts for goods, services, digital content and unfair terms in consumer contracts. The Bill was not designed to make further changes to financial services legislation.

We are focused on implementing the legislative changes contained in the Financial Services Act 2012 and the Financial Services (Banking Reform) Act 2013. While we are working closely with BIS in respect of the Consumer Rights Bill, we are not advocating further changes in financial services legislation.

#### **Parliamentary Commission on Banking Standards (PCBS)**

In September 2013 the Government asked Sir Richard Lambert to create an independent body that would promote high standards of competence and behaviour across the UK banking industry. In response to a consultation issued by Sir Richard, the Panel said that the new organisation needed to address the following:

- Low levels of professional standards. Out of over a million people working in the banking sector in the UK, the Chartered Banker Institute has just 9,000 members, of which only 4,000 hold the highest level of qualification.
- The failure of banks and individuals within them to face up to their responsibility to customers.
- The lack of corporate responsibility within the banking sector.

The Panel believes that the test will be whether new standards generate significant behavioural change. It also suggested in our response that the new body should work closely with the FCA as it develops the new Senior Persons Regime.

We agree that the test of both Sir Richard Lambert's proposals and the new Senior Persons, Certified Persons and Code of Conduct, is whether they generate significant behavioural change in industry. We are working with Sir Richard Lambert and will work closely with the Banking Standards Review Council (BSRC) as we develop our new regimes.

#### **Regulation of consumer credit**

The Panel believes our consumer credit regime needs the following to deliver good outcomes for consumers:

- **Enforcement:** we need to have an appetite for early intervention and strong enforcement to protect consumers, provide clear deterrence and maintain a level playing field for fair trading businesses.
- **Flexibility:** it needs to be constantly evaluated to ensure it is delivering its

objectives and changes are made where it is not.

- Partnership and cooperation: we need to invest substantial time and effort in ensuring effective relationships exist with local authority Trading Standards Services, illegal money lending teams and other organisations we have not previously worked with to any great extent. This will be particularly important in ensuring unauthorised firms are not operating in this sector.

We have stronger powers and more resources than the Office of Fair Trading (OFT) to regulate consumer credit, and our supervisory approach is risk-based and proactive to allow us to identify consumer harm quickly.

Where we have identified a risk of ongoing consumer harm, our Supervision and Enforcement divisions have worked closely together to quickly use our powers of intervention. Since 1 April 2014 we have placed requirements on consumer credit firms, including ensuring loan agreements are legally and fairly enforced where the consumers are unable to repay the loan and stopping a payday lender from selling single instalment payday loans.

We can take disciplinary action against firms and individuals whose conduct falls below the standards we expect. On 30 April, we published a list of approximately 13,000 firms that had held a license with the OFT on 31 March, but had failed to apply for interim permission with us, or indicate that they intended to exit the market. We have published 30 specific consumer alerts about unauthorised firms that did not hold a license under the old regime, but have been reported to us for offering credit services.

We regularly review the effectiveness of our new Handbook rules on flexibility - for example, we are carrying out thematic work on arrears and debt management and how customers in financial difficulties are treated - and we are considering whether new policy rules need to be made. We are also committed to reviewing conduct requirements that are retained in the Consumer Credit Act 1974 to assess whether the retained provisions work well or whether there is a need to develop FSMA rule-based alternatives.

We have been working closely with the national representative bodies for local authority trading services, and have developed and agreed a Memorandum of Understanding that facilitates the exchange of information and framework for cooperation and coordination. We continue to develop a working relationship between us and local authority trading standards offices. We have also developed a cooperation agreement with the Citizens Advice Bureau.

The information gathered by local Authority Trading Standards offices through their enforcement of fair trading standards, and by the Citizens Advice Bureau through its debt advice work, is an valuable source of data that informs our reviews into both existing and emerging consumer credit issues. We are in regular contact with them, and have developed an agreement to cover operational issues arising out of casework, as well as having regular meetings to deal with governance and strategic issues arising out of the joint remit to deal with unauthorised firms that carry out consumer credit business.

### **Principles of consumer representation at EU level**

Following some research into consumer representation at EU level that it published, the Panel made a number of recommendations, including:

- The need for all member states' financial services regulators to have a consumer protection objective.
- The importance of European Supervisory Authorities (ESAs) demonstrating clearly how they are meeting their consumer protection objectives under Article 9 of the ESA founding regulations.



- Recommendations relating to the operation of the ESAs and their stakeholder groups, relating to resourcing, support and recruitment.
- An investigation by pan-European bodies, with an explicit consumer remit, into the feasibility of developing a European consumer data hub.

We acknowledge the Panel's concerns over the importance of ensuring adequate and consistent levels of consumer protection throughout the single market.

The precise means of achieving this may legitimately vary between member states, given the differences, for example, in the nature of retail financial markets. We highlighted the importance of stakeholder groups and the ESA Article 9 consumer protection functions in our response to the European Commission's ESFS review. We also offered some practical suggestions on how to improve their efficiency.

### **Banking and payment services at EU level**

Regarding the Payment Accounts Directive – covering the transparency and comparability of account fees, account switching and access to basic accounts – the Panel believes it is important to address both demand and supply issues relating to access to bank accounts.

Charges should be transparent and all charges for all banking services should be available to consumers, not just a representative sample.

Political agreement on the Payment Accounts Directive was reached in March 2014 and we expect it to be published in the Official Journal later this year. We worked with the Treasury during the negotiation of the Directive.

Payment Services Providers are already under various legal duties to disclose fees and charges to consumers, such as under the Payment Services Directive. The Payment Accounts Directive seeks to ensure, in addition to this, that the most relevant charges for banking services are presented to consumers in a comparable format to assist shopping around. We will work within the EBA to ensure that this information is presented to consumers in the most useful manner.

### **The Review of the European System of Financial Supervision**

Following the review of the European System of Financial Supervision in July 2013, the Panel emphasised that consumer protection should be one of the first priorities of the ESAs.

The Joint Committee on Consumer Protection needs to be given higher priority as part of a coherent consumer protection agenda. Consumer protection should be an explicit objective of financial services regulation, and its achievement should be measured against specific, measurable outcomes.

We agree that consumer protection must remain central to the works of the ESAs. We remain fully committed to the ESAs' Consumer Protection work and we are fully involved in all three ESAs Consumer Protection Committees.

### **Balance of Competences Review**

In January 2014 the Panel responded to the Treasury's call for evidence on the Balance of Competences Review on the Single Market: Financial Services and the Free Movement of Capital.

The Panel's main message was that in many areas the UK leads the way in terms of

consumer protection, and that protecting existing consumer rights should be a negotiating priority for the UK authorities at EU level.

However, it believes that in some cases there is scope to increase protection, by adopting best practice or by taking on elements of consumer-supporting legislation from elsewhere, such as adopting the wording from the MiFID Directive that a firm should act 'honestly, fairly and professionally in accordance with the best interests of its clients'.

There is also scope to increase protection for UK consumers by addressing issues at EU level, particularly where the home base of a company is not clear, where the consumer may be travelling or working outside the UK, or where a business is operating cross-border.

We continue to play an active role in policy developments and driving the consumer protection agenda in Europe and internationally, both in the development of broad standards and in the detailed rules that affect UK consumers and firms.

## **Products and services**

### **Savings and investments**

The Panel responded to our consultation on which permissible actions or legitimate expenses could be attributed to dealing commissions. It was concerned that problems identified as far back as 2001 would persist without structural reform, and asked us to consider banning commission charges to the fund altogether, allowing the fund management industry and clients to devise an optimal charging method.

The Panel was disappointed that our final policy statement in May 2014 did not ban commission charges altogether.

In 2014/15, the Panel will look at investment costs and whether they are justified and transparent.

As we set out in October 2013 at our Asset Management Conference, our work on the use of dealing commission consists of two distinct workstreams:

1. Making more immediate clarifications and enhancements to our rules in response to the issues identified in our 2012 review of investment managers' conflicts of interest in this area.
2. Launching a wider review of the regime to consider whether more fundamental reform is needed in the medium term. This involved a thematic supervisory review of buy side and sell side firms, and industry roundtable discussions on the use of dealing commissions and the market for funding research. The wider review seeks to inform parallel EU discussions on reforms to MiFID that may bring fundamental structural change in this area by early 2017.

CP13/17 and PS14/7 were designed to deliver immediate improvements to the clarity of our rules and ability to supervise them effectively, while not ruling out further reform.

We are aiming to publish an update on the wider review, feeding back on the findings of our supervisory work and discussions with stakeholders, and considering the case for more structural reform in the context of developments in EU discussions on MiFID II.

We welcome the Panel's input on this next stage of work in due course.

## **With profits**

The Panel challenged us on our proposals to enable mutuals with a single common fund to separate that fund from any non-with-profits fund. It was concerned that the proposals did not protect with-profits policyholders' interests and rights.

It was also concerned that a sale of a closed with-profits book (following the division of the common fund) might be made to a consolidator that does not have a track record of treating customers fairly, and where the with-profits committee's independence might be in doubt. Also, while sales of closed books to another mutual are generally preferable, some mutuals might not be sound businesses.

It recommended that the independent expert appointed to oversee the separation of the fund should have actuarial expertise, as well as access to other relevant knowledge, such as legal expertise. It also recommended that the expert be required to consider the need for a policyholder vote and to seek an independent external legal evaluation of policyholder interests and rights.

There has been a long running debate on the future of with-profits mutuals and what should happen when their with-profits business goes into run off.

The new initiative we have adopted is an option to apply for a modification to the rules in COBS 20 and elsewhere to allow the firm to identify a mutual member fund which would not have to run off from the remaining with-profits element of the fund. We met members of the Panels before the final version of our policy statement 14/5<sup>3</sup> was published in March 2014 and took their comments into account.

When we receive applications under this initiative we will continue to brief the Panels as appropriate and the Consumer Panel in particular has asked to remain informed.

## **Mortgage prisoners**

The Panel urged us to act on the potential for unfair treatment of people who are trapped in an expensive contract, for example when a fixed-rate deal ends and they are unable to change product or provider as they no longer meet affordability criteria.

It suggested a specific rule to protect these 'mortgage prisoners' from being treated unfairly, rather than the evidential provision that currently exists. It has concerns about the level of protection the current evidential provision provides.

The Panel will continue to press its concerns on this issue.

We expect lenders to treat existing customers fairly and not take advantage of their situation if they are unable to move their mortgage to another lender, as set out in MCOB 11.8.1E. We continue to monitor lenders' behaviour. We published a discussion paper in July on the fairness of changes to mortgage contracts, seeking views from both firms and consumers on this topic.

## **Interest rate stress tests**

The Panel recommended that interest rate stress tests should be used counter-cyclically and that the decision on these should be taken by us partly in light of, and coordinated with, the macro-prudential policy stance of the Financial Policy Committee (FPC).

It is pleased that we are proposing to amend our affordability rules to require mortgage

<sup>3</sup> <http://www.fca.org.uk/news/ps14-05-response-to-cp12-38>

lenders to have regard to any future FPC recommendation on appropriate interest rate stress tests.

Following consultation we amended our affordability rules, with effect from 2 May 2014.

## **Annuities**

The Panel recommends that we should:

- Embody in regulatory rules and mandatory standards the equivalent of a code of conduct for the non-advice market, which emphasises the need for high professional standards, the transparent disclosure of charges, and a clear explanation of the implications of non-advice for consumer protection.
- Address the causes, including light-touch regulation and non-transparency of commission, of the current regulatory arbitrage in which non-advice services are expanding at the expense of the professional advice market.
- Undertake a rigorous market study to examine among other things the possible exploitative pricing of annuities sold by insurance companies to their DC customers who have saved with them for a pension.
- Strengthen the definition of the Open Market Option.

We carried out a thematic review of annuities and found many consumers do not shop around and are missing out on a more generous retirement income. We also found that, overall, firms expect the annuities they sell to their existing pension customers to be more profitable than business conducted on the open market.

We are now conducting a market study into retirement income to explore measures to improve shopping around, and to investigate other aspects of the market that did not seem to be working well. The revised terms of reference of this study can be found on our website, which offer more detail on the scope of the work.

One aspect of this market study work is to assess the value for money associated with consumers adopting different at-retirement strategies, using current market conditions and existing products to establish a current baseline.

Alongside this we also have our supervisory review of pension providers' retention strategies and sales techniques when selling annuities to their existing customers. This will help us pick up on any issues – for example, regarding shopping around or the open market option – and work with firms to address them.

Good and poor practice identified through our review will feed into our market study and form part of the evidence-base for the development of the guidance guarantee, which will help address some of the issues around consumer engagement and switching.

## **Equity release**

The Panel were concerned about the lack of effective competition and innovation, and the quality of consumer-focused advice within the equity release market.

It encouraged us to consider whether the equity release market is working in the interest of consumers and was pleased that our market study on retirement income will touch on equity release products.

Our retirement income study focuses on products that provide an income during retirement that are purchased by individuals from an accumulated Defined Contribution (DC) pension pot.

These products are typically annuities and income drawdown products, bought through either through the open market or from the provider of the existing pension scheme. The existing pension provider might offer their own products, or another provider's product through a tied arrangement. Retirement income products purchased using a DC pension pot can vary in relation to the amount of income they provide, the period of guarantee, the amount of investment risk taken on by the consumer, the flexibility provided by the product, and the treatment of the remaining funds on death of the product holder.

There may be a number of additional sources of funding for retirement income for these consumers. For example, some people may have also paid into a Defined Benefit pension scheme, from which they will receive income during their retirement, in addition to the state pension. Consumers may also have access to funds or assets that are not related to their pension, but that can be used as a source of retirement income (for example, savings, other investments, or equity release).

Although these are not our primary focus in this study, we will look at how these alternatives affect the decisions about the purchase of a retirement income product from a DC pension pot both now and in the new at-retirement landscape. Should we identify issues in relation to these related products, we will consider what further action is needed.

### **High-cost short-term credit**

The Panel welcomed the action that we're taking to minimise the potential harm caused to consumers by the high-cost short-term credit (including payday) lenders. However, it believes that in 2014/15 there may be a need for more focus on other parts of the credit sector.

For example, most overindebtedness in the UK still arises from the use of credit cards and overdrafts.

The Panel welcome our recently announced review of the credit card market and our research in April 2014 identifying harm to consumers in the overdraft market. It believes that a cap on the cost of high-cost short-term credit should apply to all forms of such credit, not just 'payday' and other short-term loans.

We have a duty to cap the cost of high-cost short-term credit (HCSTC) by 2 January 2015. So that we could meet this deadline, we were given powers to request information from firms offering HCSTC before the transfer of regulation. We have now rigorously analysed firms' business models and the potential impact of the price cap on consumers and competition in this market.

We agree that there are important issues of detriment to consider in the credit card and overdraft markets. We have published consumer research on logbook loans, HCSTC and debt management, and announced a thematic review of debt management firms. In light of this, we will consider whether to consult on new rules if necessary.

### **Second charge lending**

The Panel have asked us to ensure that the interim arrangements for second charge lending are not exploited.

Responsibility for the regulation of second charge mortgages transferred from the OFT to the FCA with the regulation of consumer credit on 1 April 2014.

Second charge lending will be subject to a different regulatory regime once the Mortgage Credit Directive is implemented. In the interim period, we have not extended regular

reporting requirements on second charge lenders that are not already subject to them because we want to minimise the costs for firms.

However, we can request ad hoc data where we feel it is necessary as part of our day-to-day supervisory work, and once a firm has been authorised it must submit its complaints data to us. We monitor activity across all the credit sectors and consider that our interim arrangements should enable us to supervise second charge lenders robustly.

## **Crowdfunding**

The Panel supported our policy statement introducing protection for investors in crowdfunding and similar activities. It considers it was vital that the protections for this type of investment are proportionate to the risks involved. It believes this will be a good test of our preventative philosophy.

We recognise that consumers may find it rewarding to be involved in a business or project as it develops, or to support a local initiative or other individuals. Crowdfunding can also be a useful way for organisations or individuals to access finance that banks or other lenders are not prepared to offer, or only offer at a high cost. So this source of finance could benefit the wider economy, or a local economy. However, buying securities or lending via crowdfunding platforms often involves greater risks than other investment products.

To balance the benefits and risks of crowdfunding, we have sought to develop a proportionate regime that allows the market to grow, while guarding against risks to consumers.

## **General insurance**

The Panel published a short report in July 2013 setting out six challenges for the industry to improve the market for general insurance in the interests of consumers. It called for the industry to:

- Be explicit where cover which a consumer might reasonably expect to be standard does not form part of a policy.
- Show clearly in cash the price increases to auto-renewed policies and remind consumers in good time that they can shop around for a better deal.
- Be clearer about the fees charged for basic policy changes and ensure charges reflect actual costs.
- Ensure information is presented in a way that encourages consumers to look beyond price when comparing policies, in line with Association of British Insurers' best practice guidance.
- Be clearer about who owns comparison sites and whether or not they cover the whole of the market.
- Put customers first, reward loyalty and move away from a culture that treats consumers with suspicion.

In March 2014, we published preliminary findings for the general insurance add-ons market study. Our study found that competition is not effective in these markets, which can lead to poor consumer outcomes, such as consumers overpaying for add-on products. We will publish our final findings later this year, as well as consult on remedies to address the issues found.

We have also carried out thematic work on mobile phone insurance (MPI) and conflicts of interest, which examined whether firms were had appropriate measures in place to identify and manage potential conflicts of interest.

Following on from our thematic work into Motor Legal Expenses Insurance, the industry has moved away from selling insurance add-ons on an opt-out basis.

We recognise that while insurance back-books can provide some benefit to consumers, firms often target consumers' inertia by offering existing customers worse renewal prices than new customers. We have identified the treatment of new and existing customers as a priority.

We have completed a review of the terms of auto-renewal clauses and practices, and we are conducting significant research into how smarter disclosures in renewal letters impact on decision making. This behavioural analysis will give us insight and evidence in to what makes for better or more effective disclosure to consumers.

We expect firms' charges to not penalise consumers and to be reflective of cost.

We have carried out thematic work on price comparison websites and motor legal expenses insurance, which looked at whether consumers were able to make informed choices and achieve fair outcomes when purchasing general insurance products.

We have focused on all parts of consumers financial journeys, including sales experiences, and our supervisory work has focused on ensuring firms put consumers at the heart of their business model and deliver fair outcomes.

## **Redress**

The Panel believes that the Financial Services Compensation Scheme (FSCS) plays a key role in ensuring consumers' assets are protected and in maintaining confidence in the financial system. It believes that compensation limits should be applied to each brand and has engaged with us, the FSCS and the PRA on this issue.

It believes that customers should be clear about how much of their money is protected, and that different brands may be owned by the same entity. It does not feel that the different arrangements are clear to consumers and would like to see consistency. It also has concerns around the provision for temporary high balances, but is pleased that these will be addressed by the Deposit Guarantees Scheme Directive.

Under the Financial Services and Markets Act 2000, the Prudential Regulation Authority (PRA) makes the rules relating to FSCS cover for deposits including the level of protection for different brands owned by the same entity.

The Bank of England's website explains FSCS cover in relation to banking and building society brands and includes a list of the principal banking brands and building society brands covered by the FSCS on its website.<sup>4</sup>

## **Advice and accessibility**

### **Warning notices**

The Panel welcomed our decision to publish information about enforcement warning notices as it felt that this had the potential to be a strong deterrent and deliver quicker outcomes by encouraging firms and individuals to settle cases at an earlier stage.

We were given the power to publish information about enforcement warning notices by the Financial Services Act 2012. In determining how to use this power we took the views of the Panel into account, but also concerns raised by other stakeholders. Our policy,

<sup>4</sup> <http://www.bankofengland.co.uk/pr/pages/authorisations/fscs/bankingandsavings.aspx>

which came into effect in October 2013, strikes a balance between promoting the early transparency of enforcement proceedings and limiting the risk that publication will cause harm to the subject of the warning notice.

Our policy provides that we will consider the circumstances of each case but will usually consider it appropriate to publish a warning notice statement, which will set out a brief summary of the facts which gave rise to the warning notice to enable consumers, firms and market users to understand the nature of our concerns.

The warning notice statement will usually name the firm under investigation, but only in certain circumstances will an individual be named. The final decision will usually be made by the chairman of the Regulatory Decisions Committee, who will first consult the person under investigation and take into account any evidence they provide that publication would be unfair.

By the end of May 2014, we had published 10 warning notice statements. All of these related to warning notices given to individuals, none of which were named in the warning notice statements.

### **The Retail Distribution Review (RDR)**

The Panel responded to our consultation paper on referrals to discretionary investment managers and adviser complaints reporting.

It disagreed with our proposal that payments for pre-RDR referrals to discretionary investment managers should continue, with only new payments on top-ups being banned. It argued that the continuation of referral fees could act as an incentive for potential bias in the client relationship. For example it may encourage the retention of business when it might be in the consumer's interest for the business to move. It was also concerned that this sends the wrong message to the industry and leaves room for bad and corrupt practices to exist in the market.

The Panel is disappointed at the continuing low levels of compliance with the RDR. It is urging us to consider the effectiveness of our regulatory tools and, in particular, how we deal with persistent non-compliance.

We also deem the level of non-compliance to be unacceptable. We are now considering referring firms with the most egregious failings to our Enforcement and Financial Crime Division.

### **The non-advice market**

The Panel called on us to introduce a code of conduct to set minimum standards for 'non-advised' internet sales.

Its annuities research found that some sites do not draw attention to the fact that the purchase would be execution only, resulting in reduced consumer protection and access to redress. Nor is it always clear to consumers that they pay commission on these sales.

The Panel will continue to lobby us to do more to clarify to consumers the differences between advice and non-advice.

We carrying out a significant amount of work to deal with issues in this market, including publishing guidance clarifying the regulatory requirements for non-advised sales and sales via simplified advice processes, and a thematic review highlighting the importance of good product governance in ensuring firms design their non-advised services to meet the needs of their customers.



## **Financial access and vulnerability**

The Panel believes that terms like 'vulnerability' and 'disadvantage' are used inconsistently and interchangeably in financial services to imply a risk of harm to consumers. As a result these concepts may be applied in a way that leads to consumers who are vulnerable being treated as a low priority because they do not fit the definition.

It supports us in our aim for all financial services firms to create and put into practice appropriate strategies to address the needs of consumers in vulnerable circumstances.

We are grateful for the support of the Panel for our work to address the needs of consumers in vulnerable circumstances. We recently commissioned research, published in April, showing the particular motivations and behaviours of more vulnerable consumers in the consumer credit market.

More widely, we have found that an outcomes-based approach is more readily understood by all audiences and we are engaged in gathering evidence regarding what good and bad look like. We will use these examples to illustrate an Occasional Paper on consumers in vulnerable circumstances in 2015.

## **Competition in financial services**

### **Opening up UK payments**

The Panel welcomed the Government's decision to establish a new payments systems regulator within the FCA.

It would like us to ensure that payments systems operate in the interests of consumers, that competition in this area is promoted and that the disadvantages and weaknesses in the current self-regulatory approach are addressed.

The Payment Systems Regulator (PSR) has been established as a subsidiary of the FCA, with its own Managing Director and Board, and will become fully operational in April 2015.

In March 2014 we published a call for input, seeking stakeholder's views on the UK payments industry, in particular on issues of competition, access, governance, ownership and innovation. We are using responses to this call for inputs to inform formal consultations on the regulatory framework for the PSR as well as to identify any issues that may inform future work.

### **Cross subsidies in personal current accounts (PCAs)**

The Panel believes that the current business model prevalent in UK retail banking – cross selling on the back of a 'free' current account – mitigates against competition. This leads to cross subsidies within the PCA product market, and also across products.

It has started a study on the effect of cross subsidies on different groups of consumers, to open up a debate about whether the current model serves all consumers well.

The Competition and Markets Authority (CMA) is currently updating the OFT's 2013 review of the personal current account (PCA) market. It will publish the findings of this work and make a decision on whether or not to make a market investigation reference. A final decision on whether or not to refer the market will be published in Autumn 2014.

We are working closely with the CMA on the PCA update work, as well as the market study into SME banking (due to be published around the same time). We look forward to the conclusion of the Panel's study on the effect of cross-subsidisation and its contribution to the wider debate on whether the 'free-if-in-credit' PCA model ultimately serves consumers well.

**Financial Conduct Authority**

