Financial Conduct Authority

# Annual Public Meeting

Thursday, 17th July 2014

The QEII Conference Centre, London

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**Introduction**

Thank you, John, and again let me reiterate my welcome to the FCA's first Annual Public Meeting. It's been a very important year. A very important year for us, being our first year; a very important year for the industry, as we complete many of the reforms that were either building blocks in the UK to bring into place the sort of structure that we want to see here, or to implement many of the changes that are coming from Europe and elsewhere. So, the focus on change has been a very important one.

**How are we different?**

As a new body, we've had to carry forward quite a big legacy of issues from our predecessor, from the FSA, and we've had to do that with largely the same people, who we inherited from the FSA; largely the same rulebook, but with some additional powers; and certainly the same principles, but to do that in quite a different way.

So, one of the questions that we've had to focus on very hard is thinking about how we are different, how we can be different from the regulatory system that existed in the past. To a large part, that is about the style of regulation; not the rulebook per se, not the principles per se, but the need to be forward-looking in our approach, to use our judgement, to move away from a simple compliance-with-rules approach to, 'Are we achieving the right outcomes?' And that has been a cornerstone of our work for the year.

And so as I move on to talk about some of the activities over the year – and they will simply be some, because there have been so many different activities that we've pursued – one of the key cornerstones has been, 'How can we demonstrate that the style of regulation has changed, that we are using our judgement, that we are achieving good outcomes for consumers, and we're doing that in a forward-looking way, ideally to prevent detriment before it occurs rather than clearing up the mess?'

**Key developments**

Our Annual Report covered a lot of areas. It covered the thematic reviews that we had done on anti-money laundering, on the retail distribution review, on mobile banking. It sets out how we are delivering one of our big new responsibilities, which is to deliver a competitive market, so as a competition regulator, where we launched work into general insurance, into SME banking and into cash savings. We launched a new data strategy within the organisation, to focus on how we get the data about the industry from you, from other sources, in a way that's efficient for us and for you, and that data strategy has influenced how we look at data, how we request data.

We’ve continued to be very active in the international arena, within ESMA, the European Securities and Markets Association, which is delivering much of the European directives into our space; through IOSCO, which is delivering global standards; and indeed, through the support for the FSB, which has had the broad G20 agenda to deliver. So, there have been a large number of things that we have been doing and a large number of things that we have developed over the year.

**Behavioural economics**

What I’d like to do is to take a few of those and just spend a little time on some of the things that we have set out to do differently and consciously differently. One of those is behavioural economics. This was for the first time when a regulator really looked afresh at the paradigm of regulation, and the paradigm of regulation was largely based on, ‘If sufficient information disclosure is made, people will make rational decisions and you will always get good outcomes.’ Now, that would be a nice paradigm for us to believe in. Our experience was that actually, it didn’t work. The more information people got, the more confused they became; the more information they got, the less rational they were in their decision-making. And we looked at the psychology of decision-making and the bounded rationality that all of us as individuals face when we’re faced with complex circumstances. We looked at the interplay between a consumer trying to make trade-offs between compound interest, delayed gratification and annuity tables about longevity, and we realised that’s a set of quite complex things for anybody to understand. And we looked at how people responded to the communications that they were sent by the industry.

And we’ve used this. We’ve used our insights into behavioural economics to do a number of studies, to look at how we could better position the solutions, the products that people deliver, in a way that consumers could make better choices. In particular, we looked at general insurance add-ons and we looked at how people made their decisions. And we came forward with a number of recommendations for change in this area, such as removing the pre-ticked boxes from forms, such as requiring that on general insurance add-ons the pay-out premium was disclosed upfront, so that people could see whether this was a product that paid out 70% of premiums collected or 10%, as we saw in some cases.

So, it was an area where it informed a lot of our thinking. Much of our philosophy as to how we look at the consumer is looked at through the lens of not just the principles and the rules that people have to follow, but also our insights into behavioural economics and the psychology of investors, and that has informed our work over the last year and it will continue to inform our work.

**Warning for consumers on interest-only mortgages**

Another example I want to give is where we’ve worked with the industry to take a forward-looking approach to try to prevent a problem emerging. One of the issues throughout the period from 2000 to 2008, and particularly in the period 2005 to 2008, was the number of mortgages that were sold on an interest-only basis, and the number of mortgages that were sold simply on the expectation that house prices would rise or income would rise and therefore – or that mortgages could simply be refinanced and rolled over at a certain point in time. And we realised that when we looked into this, many, many people who had taken out these mortgages did not have credible repayment vehicles, did not have a clear understanding as to what would happen at the end of the mortgage term. While something like 90% of the people we spoke to when we sampled this industry felt they had a repayment capability, when we probed that we found that actually only about half did.

So this was a problem that was not a problem as of today, but a problem that we could have faced in five years, ten years, 15 years' time. So, we worked very closely with the Building Society Association, with the Council of Mortgage Lenders, to say, 'Let us as an industry take a proactive, forward-looking approach to how we nip this problem in the bud, how we deal with this problem.' And we had an agreement that the industry would reach out to all 2.6 million consumers, would explain again what an interest-only mortgage meant, what the consequences were, and would start to develop action plans which prevented the problem arising. And for me, this is a really good example of the regulator working very closely with the industry to take a proactive, forward-looking approach.

**Retry system for high-street banks**

Another example was, again, the agreement we reached with seven banks to use the same-day Retry system. Now, the Retry system, for those of you who are not familiar with it, deals with this problem that for many people who are financially disadvantaged, actually balances get to zero towards the end of a month and payments that would go in expecting to be sufficient to cover any outgoings weren't going in on time and people were defaulting. And we found people were often defaulting simply because of the timing difference between payments going out of an account and a salary or a benefit coming into an account. So, we said to the industry, 'We can deal with this; we can find a different solution to this.' And the industry agreed, and said, 'Okay, we will retry failed payments at a later point in the day.' The saving to consumers we estimate is around £200 million a year, from a very, very simple change of retrying a payment later in the day rather than having the initial payment default, another good example of us working very closely with the industry.

**Cash savings study**

We've also looked at cash savings. One of the concerns that we have had is whether the cash savings market adequately supplies services to consumers, and we've been particularly concerned at the use of introductory rates where people are attracted to accounts by a high-level rate which is high on the league tables, but actually that that rate very quickly drops to a negligible level. And what we found was inertia meant a large proportion of people would simply stay at those rates. And so we asked the question, 'Is this product, is this industry, best serving the needs of consumers? Is it best able to attract new competitors in who could bring new products into the industry?'

We launched that study in October last year. We've just reported back on our interim findings where we have indeed concluded that there are some shortcomings in this industry; we believe there are some problems, and we will move as a next phase to look at how we now can provide some sort of remedy which serves consumers and the industry better than we think they are being served today.

**Asset management**

Now, much of what I've talked about is at the retail market, and clearly a lot of our focus on conduct has been on retail consumers. But our remit is very broad, and it covers the wholesale markets just as strongly as it does the retail markets. One of the areas that we focused on in our wholesale market work was on the asset management industry, and in particular our realisation that the rules that the FSA introduced in 2006 on the use of commission payments weren't being adequately followed. We found that there is a large amount of payment on execution commission every year that is diverted to pay for services which are questionable, in our terms, as to whether those services are allowable under our existing rules.

So, we’ve clarified those rules; we spent a lot of time talking to the industry to clarify those rules. But also, we started a discussion with the industry about whether even those rules were sufficient. And we now have under MiFID II a European directive consultation which is asking the question as to whether commission payments, execution commission, can be used for anything other than execution. We’ve published our views on this. Our view is that we should move forward to unbundle commission payments. That is what the level one directive in the European directive says should happen. We won’t introduce new rules on this until we’ve clarified those rules at the European level, but at that point – which we expect to be early 2017 – we expect to see a harmonised rulebook on the use of commissions across Europe. And it’s very important – and it’s one of the themes I’ll come back to – very important that we develop our rules not just in a UK context, but thinking of where the UK sits both within Europe and more globally.

**Markets**

A lot of our wholesale market work has been focused on things like benchmarks, where we’ve done a lot of work since the original Libor findings to look at how benchmarks are calculated how they are contributed to and whether they’re indeed a reliable indicator of the value that they are being used to measure.

One of the things that we’ve realised is that much of this area was outside of regulatory perimeter. So, there wasn’t a regulatory perimeter that looked at Libor submissions. There wasn’t one that looked at Forex submissions. There wasn’t one that looked at gold submissions, but all of these have become more and more important as more products are created and launched around them.

So, Libor is used to value everything from very, very complex swaps in the wholesale market to mortgages in Spain. The Forex market is clearly a very, very large wholesale market, but everybody has contact with the Forex market through their holiday expenditure. Increasingly, we see products like gold and commodities not just as wholesale products, but created as retail products through exchange-traded funds and notes, certificates and notes. So, all of these are products that cover a very broad range, from the wholesale to the retail. We’ve worked through IOSCO developing a set of principles that we believe all benchmarks should operate to, and we’re in the process of working through how we ensure that all of the benchmarks that we rely on are consistent with the set of principles that we’ve set out.

**2014 highlights**

**Consumer credit market**

Let me move on to some of the things that have happened more recently. So, in 2014 we have had a very significant project to deliver, which was the taking-on of the consumer credit market. This was a market that was not part of our remit. It became part of our remit as part of the legislation that was passed, which required us to authorise something like 50,000 firms in this market, create a set of rules that were proportionate and applied to everything from car loans finance through to payday loans. And you’ll have seen more recently that we have published some more rules on the payday market in particular, the introduction of a cap, which will come in from 1st January next year. That itself has been a very significant project for the organisation; it has expanded the number of firms that we directly regulate something like threefold, so from 23,000 to something around 70,000. So, that’s a big challenge for us as an organisation.

**Credible deterrence**

We also continue to deliver our credible deterrence agenda. It's an important part of the toolkit for a regulator that where we do find problems, we're able to respond to those in an appropriate way. Sometimes that appropriate way would be to agree a redress package; sometimes the appropriate way would be a remediation plan with the firm; and sometimes the most appropriate way is through enforcement. And enforcement serves the benefit of acting both as a deterrent to those in the industry who would want to break the rules, and in terms of setting standards and lessons for all of those who are unclear about what we consider to be acceptable or not.

So, for us, the intervention through enforcement is an important part of the toolkit and will continue to be. You've seen our fines on Libor, which have been large. The interventions that we've made on gold-fix trading. The interventions we've made on some areas of insurance. HomeServe was one of those, where we levered a £30 million fine for a combination of misselling, failure to deal with customer complaints adequately and, frankly, a failure of the board, the senior management, to engage with what was a problem. You will continue to see, unfortunately, large fines as we work through the backlog of issues. Many of those issues emanate from the period around 2008, but not all of them, and some of those issues are more recent, and one of the concerns we have is the continued existence of poor practice in markets, which we have to use our enforcement tools against.

We've also pursued not just civil, but criminal. We've also pursued individuals as well as corporates, and it's important for us that we continue to have that broad-based toolkit that allows us to take enforcement action when we need to.

**Recognition**

We were given a grade A in a global investigation review for our investigation and enforcement capability. That was important to us, that we were one of only two organisations globally that received that level. We also received an award from Which? more recently which was a positive change award for the impact that we have made as an organisation on the consumer experience, and we're quite proud of this because this is not something that Which? do every year. Most of their focus, as you know, is within the consumer goods space, but they have seen that – the role the FCA has played and the difference it made as being worthy of one of their special awards. So that's something that we're very proud of, and the difference that we've made.

And we have, as John will have told you, made a significant difference in terms of how people see us, and that means you, the stakeholders. Every year we survey stakeholders we get good and bad come back to us about what we do well, what we do badly. We're pleased that this year we've seen improvements across almost every aspect that we measured. We're not the finished article, we're not where we'd want to be, but we're seeing progress and the positive progress of change, which is the directional change that we want to be moving in.

**2014/2015 Challenges**

So, there's some of the highlights. We still have a lot to do, and a lot of our work going forward will continue to focus on conduct. It will continue to focus on the tone at the top within organisations. We are seeing widespread change programmes in many of our larger financial services firms, which we welcome and are very positive. What we want to see is those change programmes delivering really good outcomes at the consumer level, at the shop floor level, and that's something that we continue to challenge and we continue to want to see. We've seen some positive steps in terms of the product being offered in the market. We've seen some firms talk themselves about scrapping teaser rates to entice people in who are then simply taken to a different rate. We've seen other products come through in the market which are innovative and positive and – we think – which are a good sign for the market.

So, we think we're seeing lots and lots of good, positive changes, but I know there is further to go and it is important that we keep that pressure on. From the FCA perspective, significant priorities remain for the year ahead. We have the introduction of the payment systems regulator, which is a new – it's a new responsibility for us. We've just appointed an MD of the payment system regulator, and we're working through exactly how that regulator will work. But that exists now as a subsidiary within our organisation. We have, as John has mentioned, a competition objective which was new to us at the start of the FCA. We continue to build that.

We continue to realise that there is much change needed in particular in the consumer credit market. Our interventions in the payday loan part of that market are very much a first stage. We want to see continued improvement in standards not just in the lending companies, but in credit brokers, in debt management firms, in many, many aspects of that market. And there's a broad question as to how much further we need to extend the very intensive approach we've taken to payday loans, which remember, in terms of the consumer credit market overall, is something between 1% and 2% of the market. So whilst it's very, very high-profile, the credit market is a very large one and extends to many aspects of consumers' experience with purchasing on credit, and they are areas that we will turn our attention to over the coming year.

**Concluding remarks**

That's a very, very quick run through of the things – some of the things that we've covered. Our annual report has those in more detail, and so I'd urge you to read it if you have the opportunity. The urgency for us remains. The burning platform that we have is still there. We still want to see continued levels of improvement, which means that the millions of consumers in the UK will get what they need from financial products, from financial markets. We want to see that the UK's wholesale markets are respected around the world, and therefore we continue to maintain the pressure on all aspects of those wholesale markets.

As I've said in many speeches that I've given over the last year, regulation is not a zero sum game. It's not a game where either the industry wins or the regulator wins. It's something where, if we get it right, everybody benefits: the regulator benefits, the firms benefit and consumers benefit. And that's the end that we want to achieve, to a market that works well – which is our overriding strategic objective – markets that work well for consumers, for concerns[?], and for the regulator.

And I'd like to thank John for his support and my executive team for their support over the last year. Thank you.