Terms & Conditions and Consumer Protection Fining Powers

Call for Evidence from the Department for Business, Innovation & Skills

Public
19 April 2016

Building Societies Association

Introduction

As a general point, we are unclear why the matters covered in this *call for evidence* were not included in the, closely-related, changes under the Consumer Rights Act last year. Firms will have reviewed, and probably changed, their arrangements in the light of the 2015 Act and the public has received a great deal of information on the matter. Much of this work would need to be revisited if the proposals in the *call for evidence* became law.

This kind of piecemeal approach to consumer legislation, which we have often seen before (eg in relation to consumer credit law) is costly for business and confusing for both consumers and businesses. A BSA article at the end of this response, written a year ago, sets out suggestions for an alternative approach to law and rule-making.

However, the overriding point we make in this response is that financial services firms are already highly conduct-regulated by the Financial Conduct Authority (FCA) in the areas covered by the *call for evidence* among others.

In the interests of both consumers and businesses, it is crucial that the kind of 'horizontal' provisions envisaged in the *call for evidence* take into account the 'vertical' requirements that already exist or are in the pipeline, for example in FCA conduct of business sourceboooks. To have similar, overlapping requirements for financial services firms and their customers would be unnecessary, confusing and give rise to potential double jeopardy.

FCA-regulated firms should explicitly be exempted from horizontal arrangements where the FCA's rules cover relevant ground. Indeed, the extent of the FCA's rules is such that we believe that BIS should, in due course, give serious consideration to the exclusion of all FCA-regulated firms from any new requirements that develop from the *call for evidence.* We have sent a copy of this response to the FCA and to the Prudential Regulation Authority.

The problem

Chapter 6 of the *call for evidence* highlights the problem, which in effect is that many consumers do not read contractual terms and conditions and, as a result, may not be aware of important provisions that bind them. Paragraph 35 notes the potential importance of behavioural psychology in relation to how consumers deal with contracts.

As acknowledged by the *call for evidence*, consumers will not be bound by unfair contract terms (under the Consumer Rights Act 2015 etc), and relevant risks are much reduced where there has been regulatory involvement – paragraph 27 specifically refers to the FCA Chapter 7 goes on to refer to additional consumer safeguards, for example in the Consumer Protection from Unfair Trading Regulations 2008.

While the FCA does not usually approve consumer contracts used by regulated firms, it sets out detailed consumer safeguards in each of its conduct of business sourcebooks https://www.handbook.fca.org.uk/handbook; for example –

- BCOBS - banking
- COBS - mainly investments (but also certain long-term insurance business)
- CONC - consumer credit
- ICOBS - insurance
- MCOB - mortgages.

Because each product area is different, the detailed provisions vary from sourcebook to sourcebook, but most of the requirements safeguarding consumers are broadly similar; for instance, relating to –

- fair, clear and not misleading communications
- acting honestly, fairly and professionally in the interests of the customer
- suitability of advice or personal recommendations
- information to customers
- commission disclosure
- where applicable, dealing with customers in arrears.

Most importantly, the informational requirements usually include the provision to customers of pre-contract Key Facts Illustrations (KFIs) – we note that chapter 8 of the *call for evidence* specifically refers to KFIs.

The FCA also has certain principles for business that firms and individuals must comply with (including fair treatment of customers); rules about incentives, remuneration etc; explicit provisions on accountability; and detailed conduct of business rules binding senior managers, certification staff and (from March 2017) nearly all junior staff, as individuals.

In addition, there are significant changes under the Mortgage Credit Directive to how financial services firms present information. There will be further changes under the FCA's Cash Savings Remedies and probably in relation to the FCA's Smarter Communication exercise, the FSCS logo

initiative etc. To ladle 'horizontal' requirements on top of all of this risks making the, increasingly difficult, aim of being clear and concise unachievable.

The FCA has also published information on how FCA-regulated firms can communicate effectively with consumers, and a considerable amount of material on behavioural psychology as it impacts on consumers' economic decisions.

It is also important to note that the FCA is a very active enforcer of relevant rules – in 2014 for example it levied in total nearly £1.5 billion in fines for conduct breaches. Also, in terms of consumer redress, around the start of 2016 firms had paid over £22.9 billion in redress for mis-selling of payment protection insurance. It is doubtful that any other sector is subject to anything approaching this level of regulatory rules, scrutiny, enforcement and fines.

Another important point is that most financial services firms are subject to the compulsory jurisdiction of the Financial Ombudsman Service (FOS). Last year, FOS resolved 448,387 complaints http://www.financial-ombudsman.org.uk/publications/ar15/index.html. We understand that FOS is the largest ombudsman service in the world – so consumers of financial services are very well served if they wish to escalate complaints.

Therefore, consumers of products from financial services firms are subject to the full range of FCA and FOS safeguards outlined above, as well as horizontal legislative requirements such as the Consumer Rights Act and the Consumer Protection for Unfair Trading Regulations. There is clearly no lack of rules or, especially in the case of FCA-regulated firms, lack of enforcement. The proliferation of FCA regulatory requirements, EU directives etc in this area restrict the freedom to rewrite and restyle terms and conditions significantly (but should also provide a high degree of protection already). Indeed, it is very difficult to see how the imposition of *additional* requirements on FCA-regulated firms could do anything other than introduce confusion and unnecessary expense for businesses and consumers alike.

In the BSA's view, as a minimum, FCA-regulated firms should explicitly be exempted from horizontal arrangements where the FCA's rules cover relevant ground. Indeed, the extent of the FCA's rules is such that we believe that BIS should, in due course, give serious consideration to the exclusion of all FCA-regulated firms from any new requirements that develop from the *call for evidence.* Should any inappropriate gaps emerge for financial services firms following the exercise, the FCA could of course examine whether any amendments to its Rulebook was needed. We have sent a copy of this response to the FCA for information.

Proposed T&C enhancements

Chapter 8 of the *call for evidence* floats a number of proposals, including the presentation of key contract terms "bold and upfront". On the face of it, this is a good idea, but it would be difficult to introduce in practice for a number of reasons.

In principle, it should be possible to identify the type of provisions that are particularly important to consumers (eg terms relating to pricing, and provisions concerning variation of terms, financial difficulties, termination of the contract etc). However, in practice, different

commentators will have their own views on what should be presented "bold and upfront" and it would be a considerable challenge to distil a wide range of legitimate, but different, views into a prescribed list that was brief enough to fit the purpose.

This proposal particularly highlights the difficulty of including FCA-regulated firms within scope. If they were included, customers of financial services products would, typically, receive both a KFI *and* the "bold and upfront" provisions. If the two sets of information were different, it would be highly confusing for the average customer and, hence, counter-productive. If they were identical there would be no point having them both. Furthermore, some financial services KFIs are required by EU law, so the picture would become even more difficult.

It should, of course, also be borne in mind that many contracts contain legally or regulatorily-prescribed provisions, such as 'heath warnings' and there is the question of how they might be accommodated into a new informational scheme.

We do not analyse each of the other proposals in a financial services context, but most would give rise to consistency issues when set against what is already required, or soon to be required, by the FCA, the EU etc. In addition, since the inception of the FSA, financial services customers have had to wrestle with the results of near-constant regulatory change – the introduction of MCOB, BCOBS and CONC, the new FCA, the Retail Distribution review, the Mortgage Market Review, the Mortgage Credit Directive, numerous current initiatives etc.

It is certainly conceivable that, rather than yet more horizontal legal change, a moratorium on new consumer laws and regulations might be the option that delivered real benefits to consumers – provided that some of the less active regulators used the period to concentrate on enforcing laws and rules that *already* existed. The key is simple, consistent laws properly enforced – a constant churn of law or regulation, sometimes as a 'message', is pointless, and unfortunately enforcement is inconsistent across different business areas.

Fining powers

Chapter 9 of the *call for evidence* sets out some suggestions for increased enforcement powers for relevant regulators. Again, the UK's financial services conduct regulator (previously the FSA, and now the FCA) has been very active and diligent in this area. For example, until recently, more than 50 undertakings were published on the FCA's website where the FCA or its predecessor had required firms to amend their contractual terms.

Last week the FCA and the Prudential Regulation Authority published a joint consultation *Proposed implementation of the Enforcement Review and the Green Report,* following a review by HM Treasury published in late 2014, which extends across the life-cycle of an enforcement case and includes processes, fining, settlements, contested decisions etc.

Therefore, again, the specific regulatory background for FCA-regulated firms would need to be thought through carefully in relation to any enhancement of enforcement powers in this area. In view of the detailed work carried out, and being carried out, by the Treasury, the FCA and the PRA, there is a strong case for ring-fencing financial services firms from relevant BIS provisions.

DEALING WITH THE REGULATORY DELUGE

By Chris Lawrenson, Head of Legal Services, BSA

First published in BSA *Consumer Outcomes* No 6: April 2015

'Deluge', what deluge?

Earlier in this edition of *Consumer Outcomes*, I referred to a regulatory and legal 'deluge'. Even leaving aside the numerous *prudential* rules and initiatives - eg from the PRA, the EU and the European Banking Authority - and significant *operational* risks such as cyber crime, there is an unprecedented level of *conduct*-related rules, laws, legal judgments and regulatory initiatives.

If you doubt this assertion, please see the earlier pages, which mainly summarise developments over the last twelve weeks or so. If you need more evidence, look at the cumulative body of rules, laws and initiatives reported in this and in the previous edition (No 5 – January) – covering in total a period of only about five months.

Nobody should be surprised, after PPI, LIBOR and FOREX, that there is a lot of regulatory activity in relation to conduct. Neither should anybody underestimate the difficulty of the task facing regulators in dealing with major issues like those just mentioned. However, we all have a right to expect such activity, and associated enforcement policies, to be focused, proportionate, co-ordinated, transparent, consistent and effective.

Unfortunately, over time we have seen a continual chopping and changing of regulatory structures, approaches, practices and enforcement policies, which has not helped businesses or consumers. The tendency of the UK authorities to 'front-run' and 'gold-plate' EU legislation hasn't helped either. And, following a sensible start in Parliament, some more recent proposals and policies under the *strengthening accountability in banking* exercise are potentially counter-productive.

My main concern is that, bit-by-bit, a situation is being created where the large majority of businesses, that want to make 'good' profits and achieve a sensible and fair balance between prudence and consumer outcomes, are forced to spend a disproportionate amount of their time and resources on compliance. Some would say that we are there already. At the same time, the small minority of firms that put profits above their customers' interests are able to shelter behind the increasing regulatory complexity, perhaps along with a veneer of 'cultural change'.

There is a better way.

It would involve fully researched, well thought out, simple rules that, wherever reasonably possible, were of a 'horizontal' nature so that they could accommodate a range of product areas and different business sectors. Necessary 'vertical' modifications would be made to take account of different products or means of delivery, but the fundamentals would be consistent across the board.

In order to enhance simplicity further, the UK would seek to influence EU laws with an intention that, as far as was practicable, they made sense in a UK context (this is not always the case – some aspects of the Mortgage Credit Directive for example), but government and regulators would not front-run or gold plate those laws.

The rules would need to focus on the right areas, and target accountability at the correct people, in the businesses concerned. In addition, the rules would need to be developed by constructive and detailed face-to-face dialogue among government, regulators, businesses and consumers. A small part of the

exercise would relate to consumers' responsibilities – consumers are entitled to know their responsibilities, but there is undue sensitivity on this topic.

Once in place, the rules would need to be enforced strongly, fairly, transparently, proportionately and consistently. They would need to be given plenty of time to bed down. Nothing is set in stone, but there should be no rush to change them or replace them at the first sign of a problem. In time, everyone concerned (including businesses and consumers) would get a proper understanding of their rights and responsibilities, which would benefit consumers and good businesses. ***But let's concentrate on the here and now . . .***

Compliance in the face of the deluge

While good firms ideally seek compliance in all respects, some degree of prioritisation of resources is essential. The table that follows gives a high-level overview of how such prioritisation might work in practice for a BSA member. If culture and governance at the top are deficient, having strong systems and controls - such as compliance and risk assessment - will not count for very much in practice. Therefore, the table assumes that the firms in question have the right cultures – a very reasonable assumption in respect of the building society sector.

The table highlights four key areas; two existing ones and two others in the pipeline for implementation within the next year. Naturally, a firm could fall down in an entirely different aspect of its retail business – as already noted, good firms want to be 100% compliant, if at all possible, but resources are inevitably finite. The point of this kind of prioritisation is to try to separate what could give you a nose bleed from what could put you in intensive care. No one wants the former and one takes reasonable steps to prevent it from happening, but the *priority* has to be averting the latter.

So for instance, some of the banks facing many billions of pounds in PPI remediation bills were no doubt compliant in some other areas – with hindsight, they may now wish that they had prioritised their risk assessment and compliance efforts differently!

Here are a few practical tips –

- take another look at whether your resources are properly applied in the four broad areas identified in the table – much work will already have been done, so it is unlikely to require a major review but, with so much happening, a brief pause for breath and a 'sanity-check' could prove useful in the longer-term

- please make sure that you are aware of the help and support available from the BSA www.bsa.org.uk/members and, if you are not certain, don't hesitate to ask www.bsa.org.uk/members/management-of-the-bsa/meet-the-team

- in particular, have another look at the BSA's conduct risk manual, the BSA's six practical resource books on *strengthening accountability in banking*, and our information on individual areas eg on the Mortgage Credit Directive and on competition law policy and practice – and, if you haven't already done so, check out our seminars and events (see page 2). Further BSA information and seminars/workshops will follow on other topics eg the Consumer Rights Act and unfair terms

- current formal rules and laws cover just about everything – from high-level principles (eg culture, TCF, conflicts of interest etc) to detailed conduct (eg information to customers, contract terms, post-contract issues etc), and across pretty much all products (including those that are core to our sector – ie savings and mortgages - and those that are less so eg consumer credit, insurance etc).

  It is a decision for each business whether it chooses to participate in any of the plethora of current 'voluntary' regulatory or quasi-regulatory initiatives but, in considering whether or not

to do so, a vital question to ask yourself is *'do we have the appetite and capacity to take on any of the voluntary programmes, while at the same time staying fully on top of the compulsory requirements'?*

RETAIL CONDUCT: KEY PRIORITY AREAS		
Area	**Why?**	**What does this mean in practice?**
Current		
1. Sales, advice & information	A major source of consumer detriment, complaints, and regulatory action including fines and remediation. If nothing else does it, the levels of PPI remediation evidence how important it is to get this area right	Focusing on key risks, including – • promotions • information to customers • KYC and advice processes and also on related and underlying matters, such as – • product governance • sales incentives and performance management • staff training • relationships with third parties

2. Systems & controls	Year-on-year, deficiencies underlie a very large proportion of regulatory enforcement	Ensuring that –
		• your systems and lines of defence (compliance, risk, audit, record-keeping etc) are, in themselves, as robust as you can make them,
		
		• they are informed by a clear understanding of conduct risks generally, and are deployed properly - prioritising key risks eg
		  ○ sales, advice & information (above)
		  ○ corporate governance
		  ○ contract terms
		  ○ arrears & possessions
		  ○ financial crime
		  ○ competition law
		  ○ vulnerable customers
		
		• new product areas/changes of strategy, and new requirements and risks, are automatically included ie risk assessment and compliance with new provisions (eg new legal judgments, new legislation such as the Consumer Rights Act 2015, and new conduct rules eg under *strengthening accountability in banking*) form part of the overall risk framework, so as to minimise duplication and to dovetail with existing workstreams – use of a risk register can be helpful

Forthcoming		
3. Mortgage Credit Directive *(deadline: March 2016)*	Important changes in a core area for our sector	Implementing the now final rules, with help from FCA materials, BSA guidance and seminars, relevant industry groups etc
4. Strengthening accountability in banking *(deadline: also March 2016)*	An exercise that will affect most aspects of your organisation	• Working on responsibilities maps, statements of responsibility, certification, potential HR issues etc, with help from BSA guidance, seminars, working groups etc, prior to final FCA rules in the Summer (which will give us a clear picture of conduct rules) • Seeking to build on existing processes and systems (APER, SIF etc) where practicable, in order to minimise changes.

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The Building Societies Association (BSA) is the voice of the UK's building societies.

We fulfil two key roles. We provide our members with information to help them run their businesses. We also represent their interests to audiences including the Financial Conduct Authority, Prudential Regulation Authority and other regulators, the government and parliament, the Bank of England, the media and other opinion formers, and the general public.

Our members have total assets of over £330 billion, and account for approximately 20% of both the UK mortgage and savings markets