

## **FSA: *Journey to the FCA***

### **Response by the Building Societies Association**

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### **Introduction**

1. The Building Societies Association (BSA) represents mutual lenders and deposit takers in the UK including all 47 UK building societies. Mutual lenders and deposit takers have total assets of over £375 billion and, together with their subsidiaries, hold residential mortgages of £245 billion, 20% of the total outstanding in the UK. They hold more than £250 billion of retail deposits, accounting for 22% of all such deposits in the UK. Mutual deposit takers account for 31% of cash ISA balances. They employ approximately 50,000 full and part-time staff and operate through approximately 2,000 branches.

2. The BSA is pleased to provide comments on the consultation by the Financial Services Authority on the FCA approach document (the consultation). The BSA has responded to a range of previous consultations on the regulatory reform exercise, all of which are public and can be located on the BSA website. We are also in the process of responding to a series of consultations dealing with detailed areas such as approved persons, authorisation and supervision, and draft secondary legislation.

3. The FSA seeks views on all the content of the consultation, but asks some specific questions (on page 60) about competition and gathering/receiving information. The response below follows the chapter sequence in the consultation and picks up on the specific questions in context.

## Executive Summary

4. The BSA supports and welcomes most of the key proposals, including -
  - the move towards more interventionist, pre-emptive regulation, provided it is handled proportionately and non-retrospectively, and is well targeted and effectively delivered
  - plans for forward-looking supervision based on the existing *life-cycle* approach to the fair treatment of customers, which remains entirely valid and is well understood by BSA members
  - the acknowledgement that the FCA and the PRA will take their co-ordination responsibilities very seriously . this is important recognition of a risk in a *win peaks* system of firms being pulled in different directions by conflicting regulatory requirements
  - the confirmation that the FCA will regulate in a transparent fashion . this is particularly important in relation to section 166 skilled persons reports, IT expenditure etc
  - the proposed *balanced* approach to consumer responsibilities
  - proposals for a Policy, Risk and Research Division at the FCA . good intelligence is an integral component of successful regulation (and effective delivery the other)
  - the sensible, pragmatic proposals regarding authorisations and reporting.
5. However, care is required on certain matters; for example -
  - the Association urges caution in the use of the new pre-emptive powers, especially pre-publication of warning notices, in order to avert a presumption of guilty until proven innocent
  - careful consideration should also be given to the needs of firms that, until now, had a nominated supervisor but which will not under the new arrangements
  - we also believe that, while co-ordination with other relevant bodies is very important, the FCA should not allow its work to *overlap* with other bodies such as the competition authorities or the Money Advice Service - it is very important that the new regulator focuses on its statutory objectives
  - the transfer of responsibility for the regulation of consumer credit from the OFT to the FCA requires great care . we provide more detailed commentary below, and
  - finally, we note that a number of highly publicised comments about the nature and the strength of the new regulator appear to miss the point . for instance, in our view, the key question is not whether the new conduct regulator is seen as being *strong* or *weak* but about whether or not . in practice - it is *effective*.

## Foreword and introduction to the consultation

Chapter	Heading	Items covered of particular interest to BSA members
-	<b>Foreword (chairman designate)</b>	<i>General introduction –</i> <ul style="list-style-type: none"> <li>striking the right regulatory balance.</li> </ul>
-	<b>Introduction (CEO designate)</b>	<i>High-level discussion of several new items –</i> <ul style="list-style-type: none"> <li>need for change</li> <li>FCA objectives</li> <li>importance of the UK financial services industry</li> <li>new regulatory powers</li> <li>focus on senior management in firms</li> <li>continued focus on TCF</li> <li>interventionist/pre-emptive approach</li> <li>balanced approach to consumer responsibilities</li> <li>FCA co-ordination with EU bodies</li> <li>FCA collaboration with stakeholders.</li> </ul>

### (a) FCA approach

6. The Association firmly supports the FCA chairman-designate's comment -

*“regulation has to strike the right balance between allowing the industry to thrive and ensuring it retains its integrity and delivers what consumers expect from it.”*

On the one hand, the importance of the financial services industry to the UK economy (explained in the CEO designate's introduction) should not deter the FCA from making tough regulatory decisions in the face of serious consumer detriment. On the other hand, the need to be seen to ensure consumer protection and to restore regulatory reputations should not lead us into disproportionate, retrospective supervision and regulation. *The key is proportionality.* And, in that regard, we welcome the statement in chapter 5 that the FCA will have zero tolerance of absolute loss to retail customers in excess of £250million. It would be unfortunate if the regulator missed serious episodes of consumer detriment while focusing on minor or marginal matters.

7. In his speech accompanying the consultation, Martin Wheatley said .

*“our approach will be more forward-looking, better informed, and we will have a greater appetite to get things done.”*

We believe that this summarises the ideal approach for the new conduct regulator. Many sectors and organisations (business, government, regulatory etc) made serious mistakes in the recent past. Now is the time for a clean sheet, as far as practicable. Without prejudice, of course, to proper redress in respect of past misconduct for consumers who are entitled, it is important for the regulator to adopt a forward-looking approach - certainly acting in an interventionist manner where appropriate - but with a primary view to ensuring that consumer protection in the future is much

better than it has been in the past. However, dwelling disproportionately on the past or, even worse, making retrospective judgments would be counter productive.

**(b) Key tenets of FCA regulation**

8. The BSA supports the key, high-level elements of the FCA plans; notably .
- the focus on senior management in firms
  - the continued emphasis on the fair treatment of customers, the six retail consumer outcomes and the ~~life-cycle~~ approach, as part of the new firm systemic framework that is replacing ARROW supervision . BSA members took the TCF project very seriously and its key tenets remain entirely valid
  - the balanced approach to consumer responsibilities . “*So all parties – consumers and firms alike – must take responsibility for their part in transactions*”. But it is disappointing that no definitive statement of consumer responsibilities has been produced . while accepting that the matter is not entirely straightforward, the BSA responded in detail to the FSA discussion paper on the subject (DP 08/05) and produced a policy statement. We believe that consumers are entitled to be made aware of their responsibilities, as well as their rights
  - the commitment to open engagement with other stakeholders, European bodies etc. Clearly, the European dimension is very important indeed and the FSA will need to co-ordinate with its other EU counterparts and should not be tempted to ~~front-run~~ EU developments that are in the pipeline.

**(c) Regulatory co-ordination**

9. However, there is an increased risk, because of the move to twin peaks, that firms could be subject to conflicting regulation by the PRA and the FCA. This risk is well recognised and we appreciate that the regulators will be under a statutory duty to co-ordinate. We hope that, in practice, the regulators take seriously the potential for firms to be put in an impossible position by conflicting regulatory requirements or directions. At a more practical level, PRA/FCA co-ordination in respect of such things as regulatory visits and information gathering, so that firms are not subject to unnecessary duplication, is also important. This is potentially another reason why it is unfortunate that the PRA and FCA IT systems will be separate (see below) and it is crucial that the parallel systems are able to communicate with each other where necessary.

**(d) Regulatory transparency**

10. The introduction mentions the plan to publish a discussion paper early next year on regulatory transparency. The BSA believes that key areas in which regulatory transparency will be particularly important include .
- *section 166 (Skilled persons’) reports* . in view of the increased regulatory powers being implemented under the Financial Services Bill, it is very important that the FCA is open and transparent in respect of process matters such as the selection of skilled persons (including relative costs); consultation with firms in respect of their particular businesses; the suitability of the subject matter for a section 166 report; arrangements for addressing potential conflict

of interests; and FCA accountability regarding the number, scale, nature etc of such reports.

- *FCA IT arrangements and costs* - year-on-year, the FSA IT spend has increased but, despite this considerable financial input, the Bank of England has made it clear that it does not regard the FSA's IT infrastructure as appropriate for use by the PRA. This means that a new IT system will have to be developed for the PRA, while continued changes will have to be made to the FSA/FCA system . meaning a double spend that will have to be financed by regulated firms during particularly difficult economic times. Hitherto, we have not seen enough transparency or accountability regarding this situation and we believe that it is crucial that this is rectified going forward.

## Chapter 1: Regulatory framework and powers

Chapter	Heading	Items covered of particular interest to BSA members
1	<i>The creation of the FCA: spotlight on some of our new powers</i>	<p>More detail of some key regulatory changes -</p> <ul style="list-style-type: none"> <li>• new regulatory framework – background and structure</li> <li>• operational risk management by firms</li> <li>• product intervention and governance</li> <li>• financial promotions</li> <li>• pre-publicising enforcement action</li> <li>• super-complaints</li> <li>• consumer credit</li> <li>• competition.</li> </ul>

### (a) New regulatory framework

11. The first part of the chapter describes plans for the new regulatory structure. The Association has commented in detail on this matter through responses to numerous consultation papers, Parliamentary Committees etc, and we, therefore, have little to add at this stage concerning the over-arching framework, which has largely been determined. Perhaps the only remaining comment is the obvious one that successful regulation is less likely to be predicated on regulatory *architecture* than on regulatory *effectiveness*.

### (b) Pre-emptive regulatory powers

12. The chapter then discusses the FCA's new pre-emptive powers concerning product intervention, financial promotions, pre-publication of warning notices etc. In the Association's view, given the events of recent years, it is both inevitable and laudable that the regulator should have stronger powers to address consumer detriment. The FSA has made it clear that firms must, for example, have strong product governance processes and must not have sales award schemes that discourage TCF. The Association supports the FSA on these matters.

13. It should be remembered, however, that strong regulatory powers existed in the past but were not always activated promptly or were sometimes used in a mis-directed way. The FCA will have a very strong responsibility to ensure that it employs the new, interventionist powers in a focused, systematic fashion. It would be unacceptable if firms were publicly sanctioned in circumstances where it ultimately turned out that they had done no wrong. Especially in this age of instantaneous communications, it is particularly difficult to restore a reputation once it has been damaged and the regulator needs to be mindful of this fact. We must not move to a position where guilt is automatically presumed. Therefore, we support in principle the development of tougher regulatory powers, whilst noting that increased powers are accompanied by heavier responsibility to use those powers properly.

### (c) Super complaints

14. Regarding super complaints, we support the new arrangements (provided both firms and consumer organisations are fully involved, and there is full consultation about the designation of super complainants), but regret that the wider

implicationsqprocess was largely unsuccessful and has not been replaced by something better. It is also a matter of regret that certain of Lord Hunt's excellent recommendations in his report on the Financial Ombudsman Service were not implemented. Having said that, we recognise that the Financial Ombudsman Service has coped very well indeed with the increasing demands placed on it over the last decade or so and believe that the Service is an invaluable one for both consumers and businesses.

15. Once the new regulatory structures are fully in place and embedded, the Association believes that the whole wider implicationsqcomplaints area needs re-visiting, not only as part of the overall work to help ensure fair treatment of customers, but also in the light of the increasing trend for some claims management companies to make complaints where the firm in question did not sell the product complained of to the consumer at all, and the phenomenon of certain organisations sending to, it seems, almost the entire UK adult population (sometimes unlawful) text messages about specific sums that individuals are allegedly owed as redress for mis-selling.

#### **(d) Consumer credit**

16. Chapter 1 also addresses the proposed transfer of responsibility for consumer credit regulation from the OFT to the FCA. While the Association supports the proposed transfer in principle, we believe that very careful thought needs to be given to how best to achieve the transfer in practice. In our view, the simplest approach - and the one most suitable in the short or medium-term - would be to -

- shift and shiftqrelevant staff from the OFT to the FCA, and
- for the FCA to have regard to the existing legislation (as it does, say, in respect of the Unfair Terms in Consumer Contracts Regulations 1999 or Payment Services Regulations 2009), rather than to attempt to transpose the legislative provisions into the FCA Handbook.

Longer-term, it would be sensible to review, and to simplify radically, consumer credit legislation, which has been subject to years of over-complicating, gold-platingqand front-runningq but this is not, in our view, a task that should be undertaken while the new regulator is finding its feet. Indeed, in principle, it would make great sense for the rules regarding secured and unsecured lending to be more closely aligned . but this would require a careful and extensive exercise conducted at the appropriate time. Our comments could prove to be entirely compatible with the interimq(2014) and fullq(2016) regimes suggested in the consultation.

#### **(e) Competition**

17. The chapter is completed by, what the FSA acknowledges, is an approach to competition that is still developing and about which the FSA seeks feedback. While the Association broadly welcomes the principles set out in the chapter, such as tacking barriers to entry and consumer inertia, we have a number of comments .

- It is important that the FCA does not overlap with the anti-competitive practices work of the OFT and, once established, the Consumer Protection and Markets Authority. The FCA will have enough work to do in carrying out its own objectives and the *enforcement of competition legislation* should be left to the relevant authorities. We believe that the *promotion of competition* is

different and the FCA should focus on that aspect of competition, resisting any drift into OFT/CPMA areas or roles.

- Careful thought would need to be given to the applicability - if any - of conduct-related mechanisms, such as product intervention powers, warning notices, the Upper Tribunal etc . to competitive matters.

18. The Association has already commented in detail on barriers to entry; see for example [www.bsa.org.uk/policy/response/OFT\\_barriers10.htm](http://www.bsa.org.uk/policy/response/OFT_barriers10.htm), and continues to participate actively in that separate, but related, debate.

## Chapter 2: 'Perimeter' issues

Chapter	Heading	Items covered of particular interest to BSA members
2	<b><i>Protecting the perimeter</i></b>	<i>Certain new administrative arrangements -</i> <ul style="list-style-type: none"><li>• 'single gateway (PRA) for FCA or PRA authorisations, applications etc</li><li>• threshold conditions</li><li>• approved persons</li><li>• change in control</li><li>• waivers.</li></ul>

19. The Association made strong representations in favour of a single gateway for authorisations, approvals etc and, therefore, welcomed the inclusion of the clauses in the Financial Services Bill to introduce the relevant arrangements. These are, of course, technical issues and the Association has recently responded separately to the more detailed FSA consultations relating to matters covered by chapter 2; namely, **CP12/24: PRA and FCA regimes relating to aspects of authorisation**, and **CP 12/26: the PRA and FCA regimes for approved persons**.

20. We also strongly welcome the confirmation in chapter 2 that GABRIEL, the system for reporting regulatory data, will continue to be used. This was also a matter that the Association called for and we support the helpful and pragmatic approach put forward in chapter 2. We note that online notifications and assessment (ONA) will also be retained, although we appreciate that it needs improvement.

### Chapter 3: Categorisation of firms and the new firm systemic framework

Chapter	Heading	Items covered of particular interest to BSA members
3	<b>Ensuring firms continue to meet our standards</b>	<p><i>Important information on how the FCA will supervise firms –</i></p> <ul style="list-style-type: none"> <li>• categorising firms (C1 – C4)</li> <li>• firm systemic framework (replacing ARROW)               <ul style="list-style-type: none"> <li>○ business model and strategy analysis</li> <li>○ continued 'life-cycle' TCF approach – governance and culture; product design; sales or transaction processes; and post-sales/services</li> </ul> </li> <li>• event-driven work</li> <li>• issues and products</li> <li>• FCA co-ordination with the PRA.</li> </ul>

21. Firms will welcome this very useful account of the way in which businesses will be categorised for FCA regulatory purposes and the additional information about the firm systemic framework (FSF) that will replace ARROW supervision. It is a little disappointing that firms will not be notified of their (C1 . C4) category until 2013, but we recognise the importance of taking time in order to get such classification right.

22. We believe that the numerical majority of BSA members will fall into the C3 classification. C3 and C4 firms will not have a nominated supervisor. Having a nominated supervisor can help build trust and knowledge between the firm and its regulator. Therefore, it is important that supervisory teams for C3 and C4 firms are well trained, both from a technical point of view and in helping foster good communications with regulated firms. The FSA currently helps promulgate sharing of good practice, as well as dissemination of information about bad practice . see, for example, the recent guidance consultation on risks to customers from financial incentives. Smaller firms can learn from larger ones and vice-versa. A risk with the new arrangements is that there will be less sharing of good practice. It is important to find ways to ensure that good practice among C3 and C4 firms is not ~~lost~~ because they will be subject to a *flexible supervisory portfolio* ie have no nominated supervisor. Perhaps some transitional arrangements could be introduced in this area and the Association would be very happy to help the FCA on this, and any other, implementational issues.

## Chapter 4: Enforcement

Chapter	Heading	Items covered of particular interest to BSA members
4	<b><i>Taking action against firms that do not meet our standards</i></b>	<p><i>Details about enforcement (but little that is new) –</i></p> <ul style="list-style-type: none"> <li>• enforcement priorities, including -               <ul style="list-style-type: none"> <li>○ more cases and tougher penalties</li> <li>○ pursuing cases against individuals</li> <li>○ getting redress for consumers</li> </ul> </li> <li>• co-ordination with the PRA</li> <li>• transparency</li> <li>• decision making processes</li> <li>• financial crime.</li> </ul>

23. This chapter provides little new information. The Association acknowledges the sensible move towards more enforcement cases and tougher penalties provided they are focused and proportionate. The chapter discusses the Regulatory Decisions Committee and the Upper Tribunal and notes that any decision to change current procedures will be matter for a future FCA board decision following public consultation. Strong, effective regulation (which the Association supports) does not require the dismantling of, or impairing, reasonable mechanisms for firms to be able to challenge regulatory decisions (which the Association would oppose) and we believe that it would be counter-productive to reduce such safeguards.

## Chapter 5: Identifying risk

Chapter	Heading	Items covered of particular interest to BSA members
5	<b><i>Building our understanding of the markets</i></b>	<p><i>How the FCA will identify risks in the market –</i></p> <ul style="list-style-type: none"> <li>• new Policy, Risk and Research Division</li> <li>• risk-based approach</li> <li>• policy making</li> <li>• the FCA Handbook.</li> </ul>

24. Some years ago, the FSA (in the face of considerable opposition from much of the industry) applied considerable resource to developing and introducing cross-subsidy arrangements into the FSCS, apparently because of concerns about collapse of large networks of intermediaries. This exercise was carried out around the same time as Northern Rock was becoming significantly over-exposed to the wholesale markets and other firms were heading towards their own serious difficulties. We recognise that this mis-targeting was in the prudential, rather than conduct, space but it is a substantial example of the need for robust regulatory intelligence.

25. Therefore, the Association strongly supports the plans for a new Policy, Risk and Research Division. We believe that the FSA's retail conduct risk outlooks are excellent publications, constantly improving over time, and that it will be very helpful to have a division dedicated to acting as a radar on retail conduct risks. As noted above, we also support the stated intention to focus particularly on high-severity risks. As the chapter states, there is wide agreement that a problem the size of PPI should not be allowed to happen again. However, our warning about retrospective regulation (see above) is important in this context. The FCA must not judge the past according to the standards of the day and needs to be proportionate in its assessment, and treatment, of risks.

26. We support the sensible plans for the regulatory handbooks, but clearly much detail is yet to be decided and we look forward to providing comments in respect of any relevant consultations. The high-level proposals concerning early engagement also appear to be laudable in principle and we look forward to receiving more information in due course.

## Chapter 6: Co-ordination with other bodies

Chapter	Heading	Items covered of particular interest to BSA members
6	<b>Maintaining effective relationships</b>	<i>How the FCA will co-ordinate with other bodies –</i> <ul style="list-style-type: none"><li>• Ombudsman, FSCS, Money Advice Service</li><li>• EU and international bodies</li><li>• consumer organisations</li><li>• firms.</li></ul>

27. The Association broadly supports the proposals for co-ordination with other relevant bodies. Whilst co-ordination is very important, it is also crucial to avert overlaps among the members of the regulatory family and other bodies. For example, the Money Advice Service is now established and well funded. Accordingly, we can see no reason why - going forward - the regulators should see it as part of their role to provide financial education or advice to consumers. Indeed, it would presumably be *ultra vires* their objectives to do so. That is not to say that the FCA should not co-ordinate with MAS in order to help the latter body focus its resources properly and to share intelligence as appropriate, but the FCA should not assume any of MAS's responsibilities. We certainly need co-ordination among the regulatory family, but each member of that family needs to know, and adhere to, its specific role or roles.

## Chapter 7: FCA accountability

Chapter	Heading	Items covered of particular interest to BSA members
7	<b>Accountability, transparency and measuring our success</b>	<p><i>New arrangements for regulatory accountability –</i></p> <ul style="list-style-type: none"> <li>• accountability, including – <ul style="list-style-type: none"> <li>○ panels</li> <li>○ complaints, freedom of information, audits</li> <li>○ transparency</li> <li>○ funding/fees/value for money</li> <li>○ FCA staff</li> <li>○ measuring FCA performance</li> <li>○ forward planning.</li> </ul> </li> </ul>

28. Strong regulation is entirely consistent with regulatory accountability . indeed, proper accountability makes it more likely that a regulator will focus its efforts towards genuine consumer detriment. Furthermore, accountability is not the same thing as bowing to business, political or PR pressure . we know that the regulator is fully aware of this point, but such pressures can be keenly felt by any organisation in certain, highly charged circumstances and it is at those times that a continued focus on fundamental objectives (ie the job at hand) becomes most important. The Association wants to see a strong regulator that fearlessly and independently tackles consumer detriment, while conducting itself in a way that is proportionate and fair both to consumers and to regulated firms . we believe that none of these things is mutually exclusive and, with the right intelligence and delivery, are all reasonably achievable.

29. The proposals for accountability look strong in principle, but it is our experience that mechanisms that appear to be robust in theory do not always stand up to practical tests. For example, will the commitment to achieve value for money mean that the high levels of (apparently unsuccessful . see above) expenditure on IT will not be repeated and that there will be genuine transparency in this area? We would welcome a formal confirmation on this particular point.

30. The consultation also considers the expectations on FCA staff and measuring regulatory success. As noted above (especially in paragraph 24), a key foundation of regulatory success is good intelligence that identifies the most significant risks. No one has a crystal ball and no risk assessment can be perfect but it is incumbent on the regulator, as well as on firms, to use best endeavours in this area. As well as intelligence, proper delivery is a key to success. In the early stages of the PPI exercise, the FSA apparently relied - unsuccessfully as it turned out - on fines, rather than on direct intervention. Equally, on the prudential side, as the FSA's own internal audit report into the handling of Northern Rock demonstrated, the failures were often basic ones concerning practical delivery eg non-compliance with established processes such as recording key meetings, document filing etc. It is clear that lessons have been learnt in *principle*, but they must be applied in *practice* as well . both by firms and regulators.

## **Conclusion**

31. The Association will respond to all the other regulatory reform consultations and looks forward to continue working constructively with the FSA Conduct Business Unit, and in due course with the FCA, on retail conduct matters. We believe that all sectors have learned from the lessons of the past, but learning lessons and applying them in practice are two different things and the regulatory reform exercise provides a genuine opportunity for all relevant parties to work together to ensure that consumers are treated fairly going forward.

The Building Societies Association  
14 December 2012