FCA: Our Future Mission

BSA response to the FCA's consultation

23 January 2017

Building Societies Association

Contents

Introduction and executive summary

This BSA paper responds to the FCA's consultation, *Our Future Mission* (the CP). Our key points and proposals are as follows –

(1) Fewer, stronger rules that are properly enforced

The BSA's main message to the FCA, and to all other interested parties, is that unnecessary complexity is the friend of bad firms and the enemy of consumers and of good firms. Fewer, stronger rules, given time to bed in and properly, and fairly and consistently enforced, would be far better for consumers than what has gone before.

(2) Coherent consumer protection

Following on from the above, we call on the FCA, the UK government and UK consumer organisations, to begin working together with businesses to develop, for the first time, a simple but comprehensive statutory consumer code to replace the current piecemeal and confusing requirements. Such a code would empower all consumers by lifting the fog of complexity and helping them to recognise and understand their rights and obligations. This would make life simpler and better for consumers, for all firms that are genuinely committed to the fair treatment of their customers, and for regulators. The preparation of a draft code over the next couple of years would also help guide the UK's approach to some elements of a review of the law enshrined in the Great Reform Act after the UK's departure from the European Union.

(3) Stable regulatory structures and requirements

Too much change in regulatory bodies and responsibilities, and the requirements regarding senior management frameworks and requirements within firms, is ultimately counter-productive. We have been through a period of great (and, in many ways, understandable) upheaval in these areas, but the best thing now for the UK economy and markets, consumers and firms would be a long period of stability in order to allow the new arrangements to bed down and take effect.

(4) Constructive engagement on risk and regulation

Most BSA members are not supervised by the FCA on a 'fixed-portfolio' basis. Therefore, the BSA places considerable focus on retail conduct risk, treating customers fairly and related matters. This aligns with the fact that TCF is at the heart of our sector's businesses.

We have strong engagement with the FCA at certain levels, but would be interested in exploring further ways that the FCA might communicate and engage with the industry and with our sector on evolving and emerging topics, and on issues that involve complicated or judgmental issues, especially in relation to retail conduct risk and TCF.

When the FCA was being established, the BSA stated that it *"would like to see a Financial Conduct Authority that is –*

- ***Co-ordinated*** *- with the PRA, as far as practicable, to avert underlaps, overlaps and diseconomies.*

- ***Cost effective -*** *the Financial Services Bill will require the regulators to act with efficiency and economy: this must be put into practice eg regarding IT systems.*

- ***Proportionate and fair*** *– that will be strong and interventionist, but that has clear, consistent expectations of firms and does not 'gold plate' the law.*

- ***Focused*** *– on the real conduct problems and potential problems and not distracted by having diverse objectives.*

These attributes, which are key to a strong, effective FCA, are much more a matter of regulatory culture than of legislative provision."

We see no reason, some five years later, to amend those views and we reflect them in much of this response.

This response is a public document. Some of the specific points we make in this response cover matters that are not entirely within the FCA's hands, eg that have political or governmental aspects, and therefore we are specifically sharing this response with certain other organisations including HM Treasury and BEIS.

Conduct regulation: past and future

We respond below to the questions set out in the CP. For ease of reference, we summarise the BSA's overall position, on each chapter of the CP that has questions, in a blue-highlighted box at the start of each section. But first we accept Andrew Bailey's invitation in the CP's foreword to ask, and suggest an answer to, a different question.

Question: in order to help meet the FCA's objective of "a clear path for financial conduct regulation in the UK", what lessons should the FCA learn from the experiences of the conduct regulators in the 15 years since the FSA assumed responsibility for regulation of financial services and markets in December 2001?

1 We believe that the answer is, in a nutshell, as follows. Unnecessary complexity is the friend of bad firms and the enemy of consumers and of good firms. Fewer, stronger rules that are given time to bed in and are properly, fairly and consistently enforced, would be far better for consumers than endless legal and regulatory change accompanied by sporadic and inconsistent enforcement. Such an approach would help repair, and enhance, public trust in the financial services sector.

2 A case in point is the scale of the financial services regulatory handbooks. In 2007 (just before the financial crash), a House of Commons library report [1] described the volume of material emanating from the FSA as *"near-legendary"* and noted how, in response to complaints of regulatory overload, it had been *"reduced now to a mere 8,800 pages".* Yet, since the formation of the FSA in 2001 (replaced by the FCA in 2013) we have had many serious conduct issues; for example, in relation to mortgage endowments, PPI, LIBOR, foreign exchange, sales incentives, systems and controls, interest rate hedging etc.

3 The comparison between the size of the regulatory output and the number of major conduct problems is as clear evidence as we are ever likely to see that *more* regulation is not the same thing as *good* regulation. Yet some people and organisations, whose reaction to problems is usually a call for additional laws or regulations, appear to disregard the clear evidence. We find this 'simplicity-denial' difficult to understand.

4 The enforcement dimension is important as well. The FSA's fines for the whole of 2007 amounted to £5.3 million. This was just before the financial crash and when much of the misconduct outlined above was (in practice) well underway, *i.e. at the point when much of the damage had already been done*. By contrast, in 2014, FCA fines amounted to nearly £1.5 *billion*. There is a great deal of evidence that this move to robust enforcement, although welcome, came too late. And, even with the advent of more robust enforcement, there was still a lack of sanctions against senior executives in many of the firms that were heavily responsible for the most serious conduct failings; but we recognise that the *strengthening accountability in banking* changes are designed to address individual accountability.

5 Therefore, in terms of lessons about regulation, the year 2007 and the period leading up to it were pivotal. It was a time of a great many regulations, little enforcement, and much misconduct. Whatever else happens, the '2007 experience' must not be repeated.

6 Counterfactuals are of course impossible to prove but, if the FSA had done a better job as a robust and consistent enforcer, we would probably be in a much stronger position now. By the same token, had the regulatory conduct rules been simpler and better-focused, it might have been easier to shine a light on some of the malpractice referred to above and

avert the need for litigation and so many complaints. For instance, the FSA's ICOB Rules failed specifically to address the underlying elements of the PPI scandal (which were not complicated), although the High Court held that the high-level principles were a sufficient foundation for enforcement purposes [2].

7 It seems reasonable to draw the overall conclusion that consumers do not benefit from:

- a plethora of rules
- that are weakly enforced.

8 It is not only the conduct regulator that has tended to over-complicate its remit. Other makers of law and regulation in the EU and the UK are also prone to this failing. Consumer Credit legislation is a case in point – front-running and gold-plating within the UK of already complicated EU measures has been very unhelpful.

9 More recently, the Consumer Rights Act 2015 attempted to codify consumer rights in the UK. This was a laudable objective but, despite being described by the Department of Business as the "biggest overhaul of consumer rights in a generation" [3] and despite having some very worthwhile features, it did not amount to a comprehensive code; for example, it omitted the important Consumer Protection from Unfair Trading Regulations 2008 (which, in turn, derived from EU law). Furthermore, only six months after the Act came into force, the Department of Business launched a call for evidence regarding certain business practices that could, and should, have been included in the Act, if it was indeed the biggest overhaul of consumer rights in a generation that it was promoted as [4].

10 In the light of such constant tinkering, it is no surprise that research has shown that a large proportion of consumers do not know about their rights [5].

11 Over the next few years, there is likely to be a real opportunity for new, UK-only consumer laws and regulations to be developed that provide a binding and stable code of consumer rights and responsibilities. The BSA already has some thoughts in this area – we set out some high-level ideas later on in this response. We call on, not only the FCA but also the UK government and UK consumer organisations, to begin working together and with businesses to develop, for the first time, a simple but comprehensive statutory consumer code. Such a code would empower all consumers by lifting the fog of complexity and helping them to recognise and understand their rights and obligations. This would make life simpler and better for consumers, for all firms that are genuinely committed to the fair treatment of their customers, and for regulators. The preparation of a draft code over the next couple of years would also help guide the UK's approach to some elements of a review of the law enshrined in the Great Reform Act after the UK's departure from the European Union.

12 Equally, too much change in relation to regulatory bodies and responsibilities, and the requirements regarding senior management frameworks and requirements within firms, is ultimately counter-productive. We have been through a period of great (although, in many ways, understandable) upheaval in these areas, including the *strengthening accountability in banking* exercise. While sensible review over time should of course take place, the best thing now for the UK economy and markets, consumers and firms would be a long period of stability in order to allow the new arrangements to bed down, become familiar, and take effect. We appreciate that such changes are often politically-driven, so this is a message to politicians just as much as to regulators.

13 Another observation concerns the FCA's engagement with, and transparency in relation to, the regulated community and their representatives. Most firms regulated by the FCA (unlike PRA regulated firms) are, for perfectly understandable reasons, not on the 'fixed portfolio' of direct supervision. This places a greater responsibility on the FCA to be as open as it practicably can be with the flexible portfolio firms and their trade bodies.

14 However, it is noticeable that, since the lead up to and publication of the Davis report, FCA representatives have tended to stick very closely to set lines – for example, FCA presentations at external events seem to be very tightly scripted and there is sometimes a noticeable reluctance, even among some senior FCA staff, to answer questions. The problem is not helped by shortcomings in the FCA speaker request system.

15 Going forward, we believe that it is important for the FCA to be as open as it reasonably can be, and to appoint staff, especially senior people, who are willing and able to have reasonably open discussions and to exercise judgment. It is much harder for industry representatives to engage openly and consistently with a regulator where discussions are too much of a one-way street.

16 The FCA Mission Conference, held in November 2016, was a refreshing change. We were very impressed by the open and constructive way that it was conducted and the willingness of the FCA, at the event, to engage on difficult issues and with contentious speakers. The FCA has continued this openness during the consultation period. We are optimistic that this is a sign of more open and constructive engagement to come.

17 Regarding regulatory structures, as well as the FCA, we have the PRA, the PSR, important 'horizontal' regulators such as the CMA and the Information Commissioner, various 'voluntary' regulators, and the largest ombudsman service in the world [6]. EU regulators and other agencies are very influential as well, of course. Indeed, it is interesting that a partial move towards convergence of financial services trade bodies is accompanied by an opposite trend regarding regulators (including voluntary ones). The overall picture on regulatory structures is not as coherent as it should be and should not be complicated still further - a long period of stability in this area would also be very welcome indeed.

18 The amount of often overlapping policy development, from a wide range of different agencies, has reached vast and illogical levels – this is not surprising in view of the number of bodies with, at least partly, overlapping remits that now exist. In light of all this, the importance of the FCA maintaining close engagement with other agencies and, in particular, government departments that generate proposals for new consumer laws, is crucial. The Financial Ombudsman Service, though not a direct rule-maker of course, is very influential and should naturally be part of the overall engagement.

19 Before turning to the questions set out in the CP, we would like briefly to comment on a point made in its introduction, on which there is no specific question, drawing especially from comments from some of our members. The FCA makes the point that "*our own information has also shown that too much information can confuse consumers".* Usually, where regulators have intervened regarding customer communications, contract terms etc, the number of words in disclosure documents, web sites etc have increased, eg the recent cash savings review changes, contract terms etc. In the past, firms have been encouraged through various bodies to consider the clarity of the language that financial services providers use, but this is increasingly difficult to achieve in the prescribed manner given the number of changes being rolled out.

20 We noted with interest the recent FCA documents about smarter consumer communications, which provide food for thought and continued discussion, and which we are still considering. However, a high-level point is that it is not sensible for regulators to encourage firms to use "*plain language with short, understandable messages*", while at the same time mandating increasingly lengthy and complicated regulatory notices, health warnings etc for firms' customer communications. None of this is easy but we need to work towards a sensible balance here, and we welcome the fact that the FCA is undertaking an open and constructive examination of consumer communication.

CP questions and BSA responses

(the headings below follow those in the CP)

- **Ensuring markets function well**

Summary of BSA position: We think it crucial for the FCA not to be distracted from, using the FCA's own words, *"engaged customers, firms and employees that follow clear minimum standards, and well-judged timely regulation."*

In our response to question 5, we support the FCA's criteria for measuring performance and comment on how they might be refined and improved.

As explained in our response to question 1, we believe that a root and branch review of the FCA Handbook is premature – we urge the FCA to wait and see what Brexit produces.

Q1: Do you think our definition of a well-functioning market is complete? What other characteristics do you think we should consider?

21 We agree with the broad thrust of the chapter; namely, that good markets are usually ensured by a combination of engaged customers, strong regulation, and proper competitive functioning of the relevant market. Early in Chapter 4 of the CP, the FCA summarises the position; ie, irrespective of the size or scale of a financial services firm or market, "*we believe that every well-functioning market requires the same conditions: engaged consumers, firms and employees that follow clear minimum standards, and well-judged timely regulation*." We would add fair and robust complaint-handling arrangements to that list. The development of well-founded public trust in an industry is a key foundation of a well-functioning market and largely flows from the other things. This is a matter that the BSA would like to explore further with the FCA as part of wider discussions (see below).

22 We believe that the CP extended the discussion out into broader areas such as economies of scale and innovation too soon. They are important topics, but they might logically have been dealt with later because their early introduction interrupted a thoughtful consideration of the FCA's key objectives.

23 The FSA and the FCA have developed a massive regulatory handbook, while being given a wide range of new supervisory areas, such as consumer credit and, possibly from 2018, claims management companies. The FCA has also (of its own volition) assumed responsibility for the regulation of competition in financial services, and has undertaken or commissioned wide-ranging studies into subjects such as behavioural economics and innovation. Regarding complicated products, as we have already noted, conduct regulators have been inclined to 'chase the complexity' in terms of development of their own rules, rather than placing the onus on firms to comply with straightforward requirements irrespective of how complicated they choose to make their own products. Ironically, we have seen (eg in relation to PPI) complicated rules that still missed certain fundamental points.

24 As explained in the introduction to this response, we believe that the key for the FCA - without losing sight of important developments, including external ones - is to row back from too broad a view and start to focus especially on, in the FCA's own words, ***"clear***

***minimum standards, and well-judged timely regulation.*"** We believe that it is much less a matter of "What *other* characteristics" the FCA might consider but more a case of retrenchment around the really important ones that are already evident. In our view, the no doubt constant pressure on the FCA and other conduct regulators to fragment, and supplement, regulatory approaches (ie "to do *something*") should be treated with very great caution, especially where the calls are unstructured, ill thought-out, or suggest 'quick fix' solutions. Less is more, *provided* the 'less' is of good quality.

25 In various places, the CP signals a review of the FCA Handbook. We think it likely that some of those responding to the CP will support this plan without sufficiently thinking it through. Once the UK leaves the EU, there is a strong prospect of UK firms being subject to a UK-only legal regime in respect of UK consumers. If so, this would have considerable implications for the FCA Handbook. Given the size of the Handbook, any root-and-branch Handbook review starting soon would need to be a very lengthy exercise and, by the time it was completed, it could well be getting close to the point at which the Handbook required reviewing again to reflect the UK's departure from the EU. While some simple and modest early tidying-up might be appropriate (possibly, for example, regarding disclosures – as signalled in FCA FS 16/10), we strongly suggest that the FCA postpone any root and branch review until the position regarding the UK's exit from the EU becomes clearer, in order to avert counter-productive front-running and confusion.

Q2: Do you think our approach to consumer loss in well-functioning markets is appropriate?

26 Please see response to Q1 above. We discuss elsewhere in this response, the importance of the regulator focusing on cases where there is (a) serious consumer detriment and (b) unethical behaviour by firms. Cases where (a) and (b) are both present should be the highest priority. Inadvertent technical breaches where consumer loss is absent or minimal should be much lower on the FCA's agenda than (a) and (b), in our view (though not of course absent from it).

Q3: Do you think we have got the balance right between individual due diligence and the regulator's role in enforcing market discipline?

27 Generally speaking, we believe that the balance is correct. Also please see response to Qs1 and 2 above.

Q4: Do you think the distinction we make between wholesale and retail markets is right? If not, can you tell us why and what other factors you believe we should consider?

28 Mostly but not entirely. As the CP recognises, wholesale and retail markets, and their respective customers, are often very different. What works in one may not work in the other. For example, regulating the conduct of a market trader is usually different from regulating the behaviour of a member of retail, customer-facing staff in a bank or building society branch. To transfer detailed 'solutions' derived from one across to the other will not usually work. We believe that, as long as the FCA has the responsibility for regulating both the retail and wholesale markets, it should treat them differently where appropriate to do so and use its best endeavours to ensure that relevant FCA staff fully understand, and have appropriate expertise, in the market for which they have regulatory responsibilities. Of course, certain fundamentals (like honesty and TCF) apply in every market, but many of the working dynamics will vary considerably.

Q5: Do you think the way we measure performance is meaningful? What other criteria do you think are central to measuring our effectiveness?

29 The CP sets out three measures. We do not suggest any new criteria, but we comment on how the existing criteria might be refined and improved – please see especially the text in bold type. The first is *'operational efficiency'* or value for money. This reflects the first of the Principles of Good Regulation [7] –

> *"We are committed to using our resources in the most efficient and economical way. As part of this the Treasury can commission value-for-money reviews of our operations."*

30 According to a recent report [8], the annual administrative costs of UK financial services regulatory bodies, ombudsmen and other relevant agencies has increased from about £200 million in 2000 to around £1.2 billion currently. As noted earlier in this response, much of the material period has been characterised by major prudential and conduct failures. We address the costs point primarily because the FCA has specifically raised it, but it is difficult to see how - on any objective basis - a 6-fold increase in costs over 15 years or so, accompanied by such levels of serious failure, represents good value for money. Good regulation can seldom be had on the cheap, but bad regulation can be very expensive as well. While nobody should waste other people's money, the fundamental point is not what regulation costs, *but whether or not it is effective*. **A move towards focused regulation, simpler rules and consistent enforcement could, over time, not only lead to fairer treatment of customers but also to some sensible regulatory economies.**

31 The second measure is *'impact of our interventions'*. In principle, it is of course right for the impact of regulatory interventions to be measured and tested in a targeted, objective and robust way, examining what has worked well, what has not worked well and what might have worked better.

32 The CP states that, among other things, the FCA "*will look at areas where we are unsuccessful and learn the lessons for future interventions"*. Such transparency has not, generally speaking, been traditionally characteristic of UK regulators (or, indeed, firms and their representatives, government departments, and many others). A notable exception was the publication by the FSA of its scrupulously honest internal audit report into its failed supervision of Northern Rock [9], which could and should have been used as a template for the future but was not. **We all make mistakes and there is no shame in that. What is unacceptable, for firms, for regulators and for anyone else, is to disregard - or, even worse, to try to conceal - their mistakes and to fail to learn the lessons from them.**

33 The third item is *'measuring outcomes in markets'*, which we support in principle and as a matter of general approach. However, we would all benefit from reasonable reassurance that the risk priorities identified annually by the FCA are as soundly-based as it is practicable to make them. **Now that the FCA has been in existence for a number of years, it might be the right time to undertake some reverse testing of the priorities identified in earlier years to assess how accurate they have been so far.**

34 Most BSA members are not supervised by the FCA on a 'fixed-portfolio' basis. Therefore, the BSA places considerable focus on retail conduct risk, treating customers fairly and related matters. We already have strong engagement with the FCA at certain levels, but would be interested in exploring additional ways that the FCA might communicate and engage better with the industry and with our sector on evolving and emerging topics, and on issues that involve complicated or judgmental issues, especially in relation to conduct risk and TCF. **As always, we would be very happy to engage constructively in those areas, looking at good practice as well as bad practice.**

- **Meeting [FCA] objectives**

Summary of BSA position: The BSA broadly supports the FCA's intervention framework, but makes some practical suggestions in response to questions 6 and 7.

Q6: Do you think our intervention framework is the correct one?

35 Broadly speaking, yes. It seems to work well and firms are now used to it. It is sometimes said that the FCA regulates against rules but enforces against principles. This is not an issue that exercises us greatly in practice, but we understand why it is occasionally remarked upon and think that it is something the FCA might consider reviewing. Indeed, in early January 2017, the FCA signalled that the point had been raised among the themes in initial feedback on the CP. As we note elsewhere in this response, a careful examination of how high-level principles can work effectively in tandem with specific rules would be very useful. It is also very important for regulation and broader policy to be aligned. As we note elsewhere in this response, the FCA's outputs do not work in isolation – those of a great many other regulators, government departments and other bodies are integral to the conduct regulation agenda, so proper sharing of responsibility and co-ordination of policy initiatives in practice is vital if things are to work better in future.

Q7: Do you think the way we interpret our objective to protect and enhance the integrity of the UK financial system is appropriate? Are there other aspects you think we should include?

36 We have no problems in principle with the arrangements set out in chapter 5 of the CP. Following the spirit of our plea (above) for consistency and stability in regulatory arrangements, we seek no amendments to those processes. The only area that might need to be revisited at some point, in the light of the result of the EU Referendum, is responsibility in relation to the UK's competiveness relative to other jurisdictions, which as the CP explains, was a responsibility of the FSA but was not applied to the FCA. However, this dynamic is likely to change significantly after the UK's exit from the EU. And we appreciate that it is, at least in part, a political matter.

37 We believe that the FCA's overall approach to the supervision of firms and sectors, including 'fixed' and 'flexible' portfolio, thematic work, market studies etc, is broadly appropriate because it prioritises the most significant areas of risk. It does, however, lead to some practical challenges eg in relation to a flexible portfolio firm's contact with the FCA, which we explore later.

38 The FCA also has responsibilities as a regulator for processes and controls to combat financial crime as part of its objective to protect and enhance the integrity of the UK financial system. As with all bodies involved in combatting financial crime, this involves addressing the difficulties of balancing effective controls to deter and detect criminal activity and safeguard consumers targeted for fraud against the inconvenience of these measures for the normal, non-criminal consumer - both in its role as a conduct regulator and in development of broader policy. We appreciate the fact that the subject is flagged up as a key area of future focus for the FCA (page 46 of the CP) and the BSA is very happy, and indeed keen, to continue engaging constructively on this important topic.

- **Regulation and broader policy – getting the balance right**

Summary of BSA position: While the FCA must, of course, be aware of relevant external developments and thinking on subjects like behavioural psychology, and (like firms) should incorporate material elements into work where it is right to do so, we believe it imperative that the FCA does not water down its regulatory focus.

It should not, like the FSA, be distracted from the pursuit of simple, clear, fair rules and strong, proportionate, independent enforcement.

We have severe misgivings about the proposal for a duty of care, which we explain in response to question 11. We suggest an alternative approach.

Q8: Where do you believe the boundary between broader policy and the FCA's regulatory responsibility lies?

39 We understand why the FCA keeps a close eye on broader policy developments and issues, such as in relation to vulnerable customers (which is also an area that the BSA does considerable work in – see below), the ageing population (another subject that the BSA is actively engaged on), behavioural psychology, innovation etc. While this should continue of course, we strongly suggest that some caution should be exercised because there is a risk of watering down regulatory focus.

40 Just as many firms that mis-sold billions of pounds of PPI were no doubt scrupulous in their compliance in other areas, the FSA spent a great deal of time and resource on various broad exercises (including, at least as early as 2008, the study of behavioural economics) while, at the same time, failing to supervise effectively enough a number of firms that had significant prudential and conduct problems. While we believe that the FCA should have an informed and wide view of relevant matters (and integrate relevant elements into its work where clearly appropriate to do so), it should not allow its central, practical focus to be drawn away from helping prevent where possible, and if not deal with, straightforward failures by firms to comply with existing rules and principles.

41 Access is an issue primarily for public policy and commercial decision-making so we acknowledge that, apart from clear competition and TCF matters, the FCA should tread carefully.

42 We understand why it is important for the FCA to consider long-term products. BSA members provide mortgages, which of course tend to be relatively long-term products and our sector is strong, for example, in the lending in – and into – the retirement market. As indicated in the CP, in long-term products, there can be a natural tension between what is fair at the outset and what is fair as circumstances change.

43 Customers are entitled to fairness up to, and at, the point of sale including fair contract terms that are in plain intelligible language, and to fair treatment post-sale (eg regarding information supplied post-contract by the provider, handling of complaints and arrears, barriers to product exit etc).

44 However, there is always a risk in any kind of long-term product (perhaps even more especially in pensions, life assurance, annuities etc than in mortgages) of decisions that were, or appeared to be, rational at the time resulting in poor outcomes in practice; for example, a person who paid premia for many years on term life assurance only to die shortly after the term expired, or a long-term investment or pension product (sale of which had been subject to proper and competent advice) providing a disappointing return

because of serious long-term economic recession, subsequent government action, or other unforeseeable developments in the market.

45 In our view, the role of a conduct regulator in such cases is to seek to ensure that the customers in question were treated fairly by the provider, but not to hold the provider responsible for matters outside of its control and which it could not reasonably have foreseen. Much the same comment is made by the FCA in chapter 7 of the CP: *"While a poorly functioning market or behaviour from firms can create harm for customers, they can also experience harm as a result of their own poor judgement or from external factors beyond their control or that of the supplier."* We welcome this statement. It is important that these sensible considerations should be applied in practice as well as being referred to in principle.

Q9: Is our understanding of the benefits and risk of price discrimination and cross subsidy correct? Is our approach to intervention the right one?

46 We believe that the role for the FCA is to help ensure that prices are transparent and, in view of its competition remit, that competition works well. But the FCA should respond very cautiously indeed if faced with suggestions that regulators should influence or fix prices. While there might be an argument for price regulation in exceptional circumstances, such state intervention generally has no place in a competitive, well regulated, free market environment.

Q10: Does increased individual responsibility increase the need and scope for a greater and more innovative regulatory response?

47 No, it essentially requires strong, fair, proportionate and independent enforcement. More widely, we believe that the FCA does have a legitimate role in promoting innovation, and we understand that Project Innovate and the Regulatory Sandbox have been successful so far. It is also naturally important for a regulator to keep up with the pace of technological change in relevant firms and markets, in order to be able to monitor and deal with any serious consequential detriment to consumers. However, as we have said before in this response, the FCA should not lose sight of its central objectives – it would be little use to consumers if the conduct regulator became famous as an innovation hub while, at the same time, presiding over more examples of serious conduct failure in their traditional forms.

Q11: Would a Duty of Care help ensure that financial markets function well?

48 The Financial Services Consumer Panel's paper from June 2015 [10] refers to recognised duties of care in other areas, such as solicitor-client and doctor-patient and recommends something similar for financial services. What this proposal fails to appreciate is that, in financial services terms, the imposition of a blanket duty of care would place a provider in an advisory position in respect of all products and dealings with a customer. Not only is this something that very many customers would not want, but it would mean that every member of staff, whether in a branch, a call centre or any other location, would need to be trained as an adviser if they had contact (other than of a purely 'ancillary' nature) with a customer. To fail to do so would place a firm at constant risk of legal challenge or complaints to the Ombudsman on the basis of breach of the duty of care. Even with appropriate staff training, the risk of challenge would increase considerably. The costs would be massive and disproportionate.

49 We do not contest the Panel's description of the underlying problem (ie "*the financial services industry has frequently sold inappropriate products on an industrial scale to customers who were later revealed not to have been properly informed of the risks involved or, in some cases, were entirely unaware that they had purchased the product at all*"). But a duty of care would be the wrong solution to the problem. We believe that the correct approach, as explained earlier in this response, would be for the regulator robustly, consistently and fairly to enforce (no matter how large or small the offending organisation) well-thought-out, clear and simple rules, while at the same time seeking to reinforce competition.

50 We have already seen the unintended, or partly unintended, consequences of other wide-ranging regulatory 'solutions', such as the Retail Distribution Review [11] – in our view, most of them would pale into insignificance next to the unintended consequences, detrimental above all to consumers, of the imposition of a blanket duty of care on financial services providers.

51 An alternative approach might be to introduce a requirement that all regulated firms should have business practices that are 'honest and fair', as part of the consumer code proposed in the 'Protecting consumers' section below, as opposed to a duty of care proposed by the Financial Services Consumer Panel. We provide more information in the next section of this response.

- **Protecting consumers**

Summary of BSA position: As noted earlier in this response, we call on, not only the FCA but also the UK government and UK consumer organisations, to begin working together with businesses to develop, for the first time, a simple but comprehensive statutory consumer code. Such a code would empower all consumers by lifting the fog of complexity and helping them to recognise and understand their rights and obligations. This would make life simpler and better for consumers, for all firms that are genuinely committed to the fair treatment of their customers, and for regulators.

Q12: Is our approach to offering consumers greater protection for more complex products the right one?

52 We acknowledge that conduct of business rules cannot be identical for every product-type and this fact is, of course, currently reflected in the separate FCA Conduct of Business Sourcebooks, in relation to investments, insurance, mortgages, consumer credit, and banking/savings/deposits (but there should be as much consistency as reasonably practicable). We also accept that there needs to be rather more detailed rules governing products where, for example, the firm gives advice or the customer provides security. However, we do not accept the idea that a regulator should, as we described it earlier in this response, "chase the complexity" at all times. Generally speaking, the more a regulator does this, the more likely that a firm that is not interested in treating customers fairly will use it as an opportunity hide behind the complexity of the rules.

53 Our vision for consumer protection is a UK statutory code for consumers that would have to be subject to considerable consultation and discussion across a very wide range of interested parties (and should certainly include substantial direct research among consumers themselves), but could include the following elements –

- **a 'horizontal', binding code of practice** - ie a compulsory code that covered all providers of goods or services (both private and public sector) to consumers

- **a statement of high-level consumer rights** - applicable to all consumers of goods and services from the private and public sectors. Some of the detail would be left to relevant sector regulators, such as the FCA, or relevant government agencies to deal with very carefully, so that they could capture necessary 'vertical' aspects for specific areas of business within their regulatory remit, which for a number of reasons may vary from sector-to-sector, including for example disclosures and redress. For more information, please see the paragraph below.

- **a statement of consumer responsibilities** – because consumers are entitled to know their responsibilities as well as their rights (this would focus primarily on honesty and adherence to the contract, but would acknowledge and accommodate the imbalance that often exists between providers and consumers)

- **strong, fair, consistent and proportionate enforcement** against the right firms and individuals, where appropriate.

- **a commitment not to change key provisions** unless there was very clear, demonstrable need to do so (for this reason, amendments to the *key* principles should be subject to primary legislation) – *if consumers are to know and understand their rights, those rights must be fully clarified and then no longer be subject to constant chopping and changing*

- **strong ombudsman arrangements, and proper regulation of claims management companies** regarding all the areas where they operate.

54 The statement of high-level consumer rights would have to be developed following detailed consultation and discussion, but might comprise the following elements –

i. ***Clear and fair information:*** (1) the firm will provide information to consumers before, during and after sale or supply that will be clear, honest, appropriate and consistent, and (2) terms in contracts with consumers will be clear and fair.

ii. ***Honest practices:*** the firm's business practices before, during and after sale or supply will be honest and fair.

iii. ***Suitable for purpose goods and services***: goods sold or services supplied will perform as the customer had been led to expect.

The list would need to be kept short in order to help with familiarisation – eg *'clear and fair'*, '*honest'*, and *'suitable'*. The classic pitfall of 'over-egging' or gold-plating should be avoided. Obviously the basic rights would have to be carefully fleshed out with underlying detail, some of it horizontal (ie applying cross-sector), but a clearly defined part of which would be left to individual sector regulators where relevant and appropriate. For example, some financial services products are sold subject to an advice process so the specific requirements for proper advice could be dealt with by the FCA under right no i (clear and fair information). Also, it is likely that consumer redress arrangements would need to be mandated at a sector level. As stated above, the FCA's approach should also recognise and address the complexities of protecting consumers and UK PLC from financial crime alongside conduct regulation. There is plenty of time to develop such a code with great care and full consultation because, realistically, it could not be implemented in practice until after the UK had left the EU.

Q13: Is our regulatory distinction between consumers with greater and lesser capability appropriate?

55 There are circumstances where it is of course right to distinguish between, say, 'average' and 'vulnerable' consumers, where such vulnerability is reasonably foreseeable/ recognisable by the provider, as is the case with the Consumer Protection from Unfair Trading Regulations 2008 (SI 2008 No 1277). It is also right for the FCA to encourage firms to help their vulnerable customers with support that addresses their particular situation at the time when they need help. As already noted, the BSA has been engaging on a range of practical initiatives concerning vulnerable customers for a considerable time.

56 However, except in relation to advised products and a few other areas, there is a practical limit on the extent to which such regulatory tailoring can reach. There is little to suggest that, generally speaking, the consumers who were mis-sold - say - pension products or PPI, or the small firms that were mis-sold interest rate hedging products, lacked any particular capability. This is another area where the FCA should not be drawn too far from its fundamental objectives.

Q14: Is our approach to redress schemes for issues outside our regulatory perimeter the right one? Would more specific criteria help firms and consumers?

57 Redress is very important but, with the largest ombudsman scheme in the world and the various other redress avenues outlined in the CP, there is no shortage of redress

arrangements. This is another area where stability is badly needed. It would also be so much better if prevention had at least as high a prominence as cure.

58 We note that in this section the CP does not address in detail the issues of retrospectivity and cases where the customer has experienced no monetary loss or detriment.

59 On the first point, we believe it increasingly important that the FCA does not judge firms with hindsight because it is unreasonable to expect a firm to meet some future, unstated standard. We very much welcome the recent statement by the FCA in CP16/26 (paragraph 2.10) relating to the matter in a slightly different context [12].

60 On the second point, as noted earlier in this response, we believe it important for the conduct regulator to concentrate primarily on those cases where there is clear loss or detriment for customers, in priority to a focus on pure technical breaches (especially those that have not harmed consumers). This would be proportionate and sensible. As a point of principle, consumers should not be given redress where they have suffered no detriment, and regulatory penalties in such cases should not be confused with redress. In such cases, sanctions against firms, where they are applied, should usually be more lenient than in cases where consumers suffer harm, unless the firm had behaved unethically.

Q15: What more can we do to ensure consumers using redress schemes feel they are receiving the appropriate level of personal attention?

61 Please see response to Q14 above.

- **Vulnerable consumers**

Summary of BSA position: The BSA has carried out considerable work in this area and we endorse a pro-active and flexible approach to vulnerable customers. We also strongly support the benefits of collaboration in providing consistency of solutions for customers who require additional help and work with government, charities and other financial services trade bodies to improve support for vulnerability in all of its forms. Our favoured approach is to focus on best practice solutions – for example, third party access, protection from scams, support for carers – that can apply to a range of vulnerabilities, rather than prioritising a single area as this best reflects the reality of the challenges of supporting vulnerable customers.

Q16: Is our approach to giving vulnerable consumers greater levels of protection the right one?

62 The FCA has done valuable work in raising the profile of supporting vulnerable customers as a management issue and in tackling payday lending practices that disproportionately affect the financially disadvantaged.

63 In terms of prioritising the protection of vulnerable consumers on a low income, we do not believe that it is appropriate to single out one vulnerability or combination of vulnerabilities as a priority above others, and we would endorse the intention for the FCA's regulatory approach to be flexible as best reflecting the real life situations that firms find themselves in with customers. In addition, there is a practical limit on how much the FCA can do in this area - see our response to Q13 above.

- **The role of disclosure in consumers' choices**

Summary of BSA position: While we should all learn from behavioural psychology where it teaches legitimate lessons, it is not a panacea. In the BSA's view, the FCA should focus on an approach where robust competition exists and is strongly regulated, where the rules and principles are simple but properly focused, and where they are strongly, fairly, consistently, proportionately and independently enforced as soon as reasonably practicable.

Q17: Is our approach to the effectiveness of disclosure based on the right assumption?

64 This section of the CP appears, in the light of major conduct failures, to retreat somewhat (though not entirely) from the idea that firms should provide clear and transparent information to customers, in favour of reliance on alternative measures drawn from behavioural economics. While we accept the validity of some of the lessons derived from studies in this area, it is important not to over-state the potential for the application of behavioural psychology. In this context, we acknowledge the realistic caveat on page 33 that "Behavioural economics does not provide a simple silver bullet."

65 For instance, while it would be inappropriate to generalise on all of the mis-selling over the last decade and a half, we can draw certain conclusions from the largest mis-selling episode (ie PPI). In 2011, *Which?* identified its 'top 5 mis-selling tactics' in this areas, as follows [13] –

1. You were self-employed, unemployed or retired when you took out PPI
2. You were sold PPI even though you had a pre-existing medical condition
3. You thought PPI was compulsory or were advised to buy it
4. You were sold insurance that didn't suit your circumstances
5. You didn't even know you had PPI….

66 Using *Which?*'s analysis as a shorthand, the failings comprised inadequacies regarding the provision, or the concealment, of information. As noted above, the High Court held that the relevant behaviour was capable of constituting a breach of FSA Principles, despite inadequacies in the relevant conduct rules. We suggest some caution, therefore, when the FCA states (on page 32 of the CP) that "*we believe there is a greater need for us to intervene with alternatives to disclosure and transparency where we believe it is required*."

67 While we have no objection to, and indeed support, innovative regulatory approaches where they are clearly justified (the banning of pre-ticked boxes that led to 'default purchases', which is referred to in the CP, for example), the PPI failings that led to remediation in excess of £25billion were made up of, by and large, mis-information and concealment of information. It is possible that behavioural psychology played a part in certain respects; eg some consumers placing excessive trust in their financial services provider or individual member of staff (sometimes referred to as persuasion and social influences, or the substitution of intuition for reasoning) [14], but not a very large part.

68 Regarding PPI, some people were sold products that they could never possibly have benefitted from (***mis-selling***), others were misled about what the products covered (***mis-selling***), some were told that PPI was obligatory when it was not (***mis-selling***), and others had a PPI product foisted on them that they never even asked for or discussed (***mis-selling***). Behavioural psychology and simple rules based around transparency are not mutually exclusive [15], but approaches predicated on the former without sufficient thought could risk obscuring the latter. We firmly believe that, had the sort of approach we

advocated earlier in this response (see "Protecting consumers") been taken, the problems could have been averted or, at least, considerably reduced.

69 Good firms will use valid aspects of behavioural psychology to help inform TCF, customer communications etc. However, there is the possibility that the small minority of firms that have no intention of treating their customers fairly could view behavioural economics as a convenient way of clouding the issue, by using it as a means of pushing a regulatory simplicity agenda into the long grass. Therefore, the FCA might be well advised thoroughly to 'test' potential rules based on behavioural psychology, on lines parallel with the Regulatory Sandbox, before introducing them in earnest. For example, if it was absolutely clear that regulatory disclosures did not work properly in respect of a particular product suite, behavioural psychology might help signal better alternative approaches – but no easy assumptions should be made, and alternative approaches would require very careful study and testing before they were regulatorily mandated.

70 We believe it imperative that the FCA does not repeat the mistakes of the past (especially those of the FSA), albeit in a different way. The approach that we have already described in this response – ie one where robust competition exists and is strongly regulated, where the rules and principles are simple but properly focused, and where they are strongly, fairly, consistently, proportionately and independently enforced as soon as reasonably practicable- is far preferable to an approach predicated upon the interpretation of psychological principles that were probably not very relevant to most of the major conduct failings in practice. Where we can learn from behavioural psychology, by all means let us do so, but it will never be a panacea in relation to the entirety of conduct breach or poor TCF, and let us also be wary of the potentially counter-productive effects of its application without great care.

71 Furthermore, we are not convinced by the specific behavioural psychological concept, referred to in the CP, of 'nudging'. In our view, generally speaking firms should not 'nudge' consumers and regulators should not 'nudge' firms. Instead of such an arcane concept, we favour the provision of clear, simple information.

Q18: Given the evidence, is it appropriate for us to take a more 'interventionist' approach where conventional disclosure steps prove ineffective?

72 Please see response to Q17.

- **When will we intervene?**

Summary of BSA position: We support an approach that prioritises serious consumer detriment and/or serious misconduct.

Q19: Do you think our approach to deciding when to intervene will help make FCA decisions more predictable?

73 There should be no place in financial services for firms that base their business models on ripping off customers – fortunately, they are few in number. As noted above, we support a regulatory approach that prioritises serious consumer detriment and/or serious misconduct. We support the toughest sanctions against firms that have demonstrably behaved unethically, rather than against those that have inadvertently broken one or more of the plethora of rules despite conducting themselves in an ethical manner.

Q20: Are there any other factors we ought to consider when deciding whether to intervene?

74 Please see response to Q17.

Q21: What more do you think we could do to improve our communication about our interventions?

75 We understand that this is a sensitive area, where it would usually be inappropriate to conduct ongoing enforcement in a public forum. However, we favour the provision of *post*-enforcement information that can be analysed and can provide lessons for the future. We have seen some useful FCA publications setting out examples of good and bad practice in various areas, and these continue to be helpful (also please see our response to Q25 below).

76 A rather more specific observation for the future is that, where a trade body or another organisation provides help to the FCA in relation to its work, it would usually be appropriate for the FCA to give the trade body at least some notice about when the FCA plans to go public on the matter.

- **Competition and market design**

Summary of BSA position: The BSA would like to see greater focus on regulatory policy driven by competition and on diversity of business form.

The ability for a customer to switch products is important, and should not be unfairly inhibited. However, many customers are happy with their products and are right to be. Switching is not the cure-all that some people apparently believe it to be.

As noted earlier in this response, very great care indeed should be taken in relation to suggestions that the regulator should intervene on prices.

Q22: Is there anything else in addition to the points set out above that it would be helpful for us to communicate when consulting on new proposals?

77 We would like to see greater emphasis on ways in which FCA policy can be driven by the promotion of competition. For example, when consulting on new rules, we believe that the regulator should pay close attention to the potential impact on different sectors and on businesses with different models. Homogeneity can sometimes lead to unhelpful 'group think', while corporate diversity can often have significant benefits for consumers. A regulatory approach that fails to accommodate business diversity can, ultimately, militate against competition and consumer interest.

78 A great deal of focus is placed on customers switching products. We naturally agree that firms should be transparent about any 'lock-in' on products, that customers should be able to switch without barriers, and that in many cases customer inertia can be contrary to their best interests. However, it should also be recognised that many customers are perfectly happy with their products and are right to be. In a competitive market, the power to switch is very important but, rather like the application of behavioural economics in regulatory rules, it is not a panacea for all ills. Indeed, where firms are providing good value and good products, then retention rather than switching should be the order of the day. We discussed price intervention earlier in the response.

- **Supervising firms**

Summary of BSA position: We believe that the FCA's overall approach to innovation should be 'enabling' rather than 'promotional'. It is also important that the FCA's approach to innovation does not prejudice smaller firms.

We support the FCA's decision to review its approach to engagement with flexible-portfolio firms, and we are in communication with the FCA about its Contact Centre and the Connect system.

Q23: Do you think it is our role to encourage innovation?

79 Our view, in respect of innovation, is that the FCA's role should be 'enabling' rather than 'promotional'. In other words, the regulator should help firms overcome technological barriers in order to help their businesses and their fair treatment of customers; another matter that we would very much like to explore further with the FCA. It is also important that the FCA's approach to innovation does not prejudice smaller firms. For example, if a smaller firm was examining the possibility of launching an innovative product, but one that was not sufficiently radical to meet the terms of reference for Project Innovate/Regulatory Sandbox, and because they also had no named supervisor, they would be left with very limited scope (ie the FCA Contact Centre) to explore things further with the regulator. This could well be an anti-competitive 'gap'. Please also see response to Q10 above.

80 A surprising omission from the CP is any specific mention of the FCA Contact Centre, although page 43 states that the FCA is reviewing its approach to maintaining contact with flexible portfolio firms. The BSA completely recognises that, with approximately 56,000 firms for the FCA to regulate, only a relatively small number of the largest can be on the fixed portfolio. However, this means that the vast majority of firms, even some quite large providers, are flexible portfolio; ie no named FCA supervisor and no regular meetings/visits. Therefore, we support the FCA's decision to review its approach to see if any sensible, proportionate adjustments can be made.

81 The BSA has been in communication with the FCA about its Contact Centre over a period of time and has recently renewed engagement on the subject. This is very constructive engagement about how our members and the Contact Centre can work most effectively together to achieve the best results. A move towards greater sector-specialist knowledge within the FCA Contact Centre would be welcome and that is a point that we are in discussion about. Some of our members have expressed concerns about certain aspects of the Connect system (applications and notifications) and we are also taking that up separately with the FCA.

Q24: Do you think our approach to firm failure is appropriate?

82 Broadly speaking, yes.

- **Our approach to enforcement**

Summary of BSA position: There is room for further engagement between the FCA and financial services sectors in relation to evolving and emerging topics, especially conduct risks, and the BSA is keen to continue working constructively with the FCA in these areas. We would very much like to explore how this work might be enhanced.

Q25: Do you think more formal discussions with firms about lessons learned will help improve regulatory outcomes?

83 As stated earlier in this response, we would be interested in exploring additional ways that the FCA might communicate and engage with the industry and with our sector on evolving and emerging topics, and on issues that involve complicated or judgmental issues, especially in relation to conduct risk and TCF.

84 Equally, discussions about lessons learned from regulatory enforcement would be helpful. We examine relevant FCA decision notices (and enforcement by other regulators, where material), report to our members, and provide them with summaries and analysis as appropriate. We believe that the FCA's enforcement annual performance account could potentially go into greater detail on the commonalities and key issues disclosed by enforcement and include lessons from, and comparison with, previous years. The synergies between the FCA's forward-looking *Risk Outlooks* and backward-looking *Enforcement Performance Accounts* could also be considered carefully. The BSA carries out its own work in these areas and, as indicated earlier in this response, we would be happy to share our findings and engage constructively with the FCA about these matters.

Q26: Do you think that private warnings are consistent with our desire to be more transparent?

85 Private warnings certainly have their place but we understand the potential tension with regulatory transparency. We look forward to commenting on any discussion or consultation papers that might arise from the forthcoming review by the FCA.

Footnotes

1. The Financial Services Authority: looking back, looking forward (SN/BT/3787), July 2007. (In June 2016, the FCA confirmed that its Handbook comprised 8,808 pages in print – about the same as in 2007 – and 12,000 rules. We understand that the FCA and PRA rules and guidance together comprise approximately 13,000 pages)

2. http://www.bailii.org/ew/cases/EWHC/Admin/2011/999.html. Clearly, there is an important discussion to be had about the use of high-level principles alongside rules. We believe that it is appropriate to use both in tandem, but it is crucial to include key requirements, in plain and simple terms, in the rules themselves – as we have seen, this has not always happened in the past and the consequences have been damaging.

3. on the Department of Business website here

4. BIS Call for Evidence: *Terms & Conditions and Consumer Protection Fining Powers* here. BSA response here

5. for example, by *Which?* here and by Teleplan here

6. http://www.financial-ombudsman.org.uk/news/417_EduPackCard-2.pdf

7. https://www.fca.org.uk/about/principles-good-regulation

8. http://newcityagenda.co.uk/wp-content/uploads/2016/10/NCA-Cultural-change-in-regulators-report_embargoed.pdf page 59

9. http://www.fsa.gov.uk/pubs/other/nr_report.pdf

10. https://www.fs-cp.org.uk/sites/default/files/fscp_position_paper_on_duty_of_care_2015.pdf

11. https://www.fca.org.uk/publication/corporate/famr-final-report.pdf

12. "We will not apply standards retrospectively or with the benefit of hindsight. This is reflected in our guidance at DEPP 6.2.9-D G" https://www.fca.org.uk/sites/default/files/cp16-26.pdf

13. http://www.which.co.uk/news/2011/05/top-five-ppi-mis-selling-tactics-253105/

14. http://oro.open.ac.uk/42192/1/occasional-paper-1.pdf

15. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/497539/16-113-ethical-business-regulation.pdf

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The Building Societies Association (BSA) is the voice of the UK's building societies and also represents a number of credit unions.

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 £345 billion, and account for approximately 20% of both the UK mortgage and savings markets