Our response to key comments from the independent panels' annual reports for 2018/19

November 2019

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1 Introduction

We have 4 independent statutory panels who advise us on our policies and practices. They represent the interests of consumers, regulated firms and markets and we are required to consult with them on the impact of our work.

The panels play an important role in both advising and challenging us and bring a depth of experience, support and expertise that helps us identify and remedy potential harm to users and markets. We consider their views when developing policy and implementing appropriate interventions.

FCA panels

The Financial Services Consumer Panel

Represents the interests of consumers and small businesses and monitors how far we fulfil our statutory objectives for them when developing rules or policy and provides us with advice and challenge.

The FCA Practitioner Panel

Represents the interests of practitioners and provides us with external input from the industry as a whole.

The FCA Smaller Business Practitioner Panel

Represents smaller regulated firms, that may otherwise not have a strong voice in policy making.

The FCA Markets Practitioner Panel

Reflects the interests of practitioners which are likely to be affected by our market-facing functions.

Each statutory panel publishes their own Annual Report detailing that panel's activities for the year and comments on the Financial Conduct Authority (FCA)'s work. Our responses to the panels' reports are grouped into two sections:

- Firstly, we look at themes raised by all or most of the panels.
- Secondly, we consider some of the specific issues raised by individual panels.

We encourage readers to also look at our Business Plan 2019/20 for further details on our current and planned work.

2 Key themes across the panels

The panels raised some common issues which we summarise here along with our response. Not every panel raised every issue covered here, nor have we responded to every issue raised.

Brexit

The Consumer Panel focused on:

- our provision of suitable and timely communication on how Brexit may impact consumers
- policy-making post-Brexit
- how the interests of consumers can be better considered

The Practitioner Panel highlighted:

- our role in maintaining regulatory continuity and consistency of global standards
- lack of collaboration between UK and EU national regulators in dealing with passporting and potential disruption in the event of a no-deal exit

The Smaller Business Practitioner Panel encouraged us to:

- increase our communications with smaller firms about planning for Brexit
- be clear about the difference in regulatory arrangements for firms passporting in and out of the UK

The Markets Practitioner Panel:

- welcomed our contingency planning for a no-deal exit but cautioned this would not eliminate risk
- urged us to work with other regulators to adopt a flexible approach with firms taking reasonable steps to comply with relevant rules

Our response

Preparing for the UK's exit from the EU has been our number one priority over the past year. Our aim throughout the withdrawal process has been to provide stakeholders with as much information as we can.

Communications on Brexit impact for consumers and firms
To ensure firms know what to do, we have advice on fca.org.uk, outlining the relevant considerations for firms. We have met with trade bodies, industry groups and engaged directly with firms. We will continue with this approach leading up to exit and beyond. In September 2019, we launched a dedicated telephone number for firms with questions about Brexit. We also increased our Brexit communications with a wave of digital and social media advertising.

For consumers, there is help on fca.org.uk for questions they have or decisions they may need to take relating to EU withdrawal.

Regulatory continuity and passporting
The Government has introduced a temporary permissions regime (TPR) to allow EU firms and funds currently passporting into the UK to continue operating in the UK if there is a no-deal exit.

The TPR ensures firms and investment funds can continue business with minimal disruption. Inbound firms will continue operating in the UK within the scope of their current permissions for a limited period after exit day, while seeking full UK authorisation. Investment funds with a passport can continue temporarily marketing in the UK. In May and October this year, we confirmed extensions for the TPR notifications deadline, which is now set at 30 January 2020.

Firms who have not notified us but need UK permission to perform their existing contracts, automatically fall within the Financial Services Contracts Regime (FSCR). This allows firms that have pre-existing contracts in the UK to wind down their business in an orderly fashion.

We have also developed arrangements for other types of EEA firms currently doing business in the UK. This includes a temporary authorisation regime for data reporting service providers, and a direction clarifying the application process for EEA market operators wishing to become a 'Recognised Overseas Investment Exchange'.

Contingency planning
Our ongoing engagement with industry has included monitoring firms' contingency planning and we will continue to work closely with industry and individual firms to minimise the risks associated with EU withdrawal.

We have been clear throughout that we cannot completely remove the risk of disruption resulting from a no-deal exit. The work we have done has minimised uncertainty and disruption for firms, markets and consumers and reduced the risk of harm.

Prioritisation of work

The Practitioner Panel encouraged us to focus on sources of harm and to consider the overall impact of interventions as well as individual initiatives. They particularly encouraged the development of success metrics and external reviews. They also recommended that in developing our plans we should review previous initiatives such as PPI, to identify the sources of harm and use these to prioritise work with the industry in preventing future harm.

The Smaller Business Practitioner Panel were encouraged to see us addressing some of the key obstacles to achieving good outcomes-based regulation. But called on us to identify a smaller number of annual priorities with clearly-defined objectives measured against outcomes. They asked for a clear articulation of what we want to achieve, rather than prescribing specific activity.

The Consumer Panel commented that they continue to push for us to clearly set out outcomes we seek to achieve for each priority we set. They commented that focusing on consumer outcomes from the outset will ensure we spend more time preventing harm, rather than addressing it after the event.

The Markets Practitioner Panel stressed that we should always consider whether UK regulation is targeted and proportionate encouraging a judgement based and outcome focused approach.

Our response

Through our annual prioritisation and planning process we look at the harm and drivers of harm within different financial sectors as well as those occurring across financial services. We then assess the most efficient and effective interventions available to us to tackle this harm and communicate these to firms through our sector views and portfolio letters. If we agree that more is needed, we may propose new activity.

As part of this process, we assess the intended outcomes and identify the evaluation tools we may use in the future and our measures of success. We work closely with other UK financial regulators to ensure that our interventions are targeted and proportionate. We do this by considering the total cost of regulation on the different financial sectors, the financial services sector as a whole and identifying opportunities for cross-regulator working.

Ahead of publishing our Business Plan 2020/21, we are looking to develop a small number of clearly-defined priorities linking our Mission to our day-to-day activity. We will provide a clearer explanation of the areas we are focusing on, outcomes we want to achieve and how these will be measured. We will set out specific interventions that aim to improve consumer and market outcomes and report on these in our Annual Report.

We are also developing a more outcomes-based approach to regulation as part of our Future of Regulation initiative.

Operational and Cyber Resilience

The Markets Practitioner Panel stated that operational and cyber resilience is a key priority for the panel and the industry. They accept the market incentive for optimising operational performance is strong but expressed concerns about public expectations of reliability.

They encouraged us to publish guidance on the types of scenarios firms should be testing against but said impact tolerance levels are better set by firms themselves. They felt the risks of specific regulation in this area could too easily create a focus on the form rather than the substance of compliance.

They also expressed concern about the lack of regulatory oversight of third-party providers.

The Consumer Panel called for boards and senior management of firms to base decisions on potential risks to consumers, rather than simply focusing on the probability of those risks materialising.

The Practitioner Panel stressed the need to target firm communication at the right level of seniority for firms to address cyber security issues.

The Smaller Business Practitioner Panel echoed this message, calling for the use of "Dear CEO" letters as an appropriate channel of communication. They also emphasised the need for a proportionate approach to smaller firms that balances limited resources against the potential impact of resilience and security failures.

Our response

Operational resilience (including resilience against cyber threats) continues to be one of our cross-sector priorities. Disruptions and failures will inevitably occur, so we expect firms to have effective recovery and resilience to an incident when it does. Responding quickly and effectively is important but not enough. The industry needs a more dynamic and forward-looking approach.

We intend to publish a Consultation Paper (CP), which will respond to feedback received to our joint Discussion Paper (DP): "Building the UK financial sector's operational resilience", published with the PRA and the Bank of England in July 2018. The CP will expand and develop the ideas discussed in the DP and include a package of proposals which we expect will help build firms' operational resilience, improve the ongoing availability of business services and promote market integrity.

In response to feedback from the panels and others who responded to the DP, we will address how we intend the policy framework to be proportionate and flexible enough to accommodate the different business models of firms.

We expect boards, or a firm's equivalent supervisory function, to have a key role to play in ensuring a firm meets its responsibilities in respect of operational resilience.

We have always been clear that firms are responsible for delivery of business services provided by third-party suppliers. We expect an operationally resilient firm to understand the role of outsourced and third-party service providers in relation to the systems and processes that support their business.

We recognise that smaller firms have more limited resources. We continue to target our communications with these firms, through reports, infographics and webinars, as well as signposting to guidance and resources from the National Cyber Security Centre.

Cryptoassets

The Markets Practitioner Panel acknowledged that cryptoassets and the raising of capital through Initial Coin Offerings (ICOs) present a risk of significant harm to retail investors and the wider market. They commented that they have cautioned us on a number of occasions that the public expect us to act if consumers lose significant amounts of money. They also encouraged us to consider regulating cryptoassets directly but recognised the risk that this could be seen as legitimising the activity.

The Smaller Business Practitioner Panel highlighted that rogue firms were aggressively targeting potential consumers and support our work to move quickly to warn the public and the market of potential losses.

The Practitioner Panel support our approach in this area and expressed the importance of us not being seen to endorse these products.

Our response

While the cryptoasset market in the UK is relatively small, we continue our focused work on cryptoassets to ensure that consumers are protected, market integrity is upheld, and that competition works in the interest of consumers.

Our consumer research indicated that only 3% of the UK population have bought or sold cryptoassets, with most transactions being less than £200 in value. We are also aware that there are less than 20 cryptoasset exchanges in the UK, accounting for roughly 2% of the average global daily trading volume.

The UK Cryptoassets Taskforce, consisting of the Treasury, us and the Bank of England, published a Final Report in October 2018 setting out the UK's policy and regulatory approach to cryptoassets and made a number of commitments.

This resulted in us publishing a Policy Statement 'Guidance on Cryptoassets'. This paper makes clear that certain cryptoassets are already within our regulatory remit, and firms carrying on regulated activities related to these cryptoassets must ensure they have the correct permissions and follow the relevant rules and requirements.

Due to our concerns about the ability of retail consumers to reliably value and assess the risks of investing in such products, we have proposed a potential ban on the sale of derivatives and exchange traded notes referencing cryptoassets in our Consultation Paper CP19/22: Restricting the sale to retail clients of investment products that reference cryptoassets. In the meantime, we will continue to warn consumers of the risks involved.

We are currently carrying out work including data collection from firms and a cost benefit analysis, to assess the level of potential harm from UK firms offering these products to retail consumers. We will publish this analysis as part of our CP above. If we decide to proceed with these measures, we would expect to publish a policy statement and final rules in early 2020.

We agree there are rogue firms in the market targeting potential consumers. We published two consumer warnings in 2017, one sharing our concerns on ICOs and a second highlighting the dangers of investing in crypto-derivatives. We are also working with the Treasury to look at how best to deal with concerns around unregulated tokens, including whether we should receive further powers to act in this space.

Mortgages Market Study

The Consumer Panel supported our vision of the mortgage market, as set out in our Mortgages Market Study but called on us to protect both current and future 'mortgage prisoners'.

The panel believes the inability for a customer to switch due to being in arrears, demonstrates a market failure and has implications for competition. If there is a cheaper deal available with their current lender, a consumer should be able to switch, whether they are in arrears or not. They called for us to consider whether more interventionist approaches may deliver better outcomes for these consumers.

The Practitioner Panel also welcome our report but called for us to focus only on areas where there is clearly harm.

The Smaller Business Practitioner Panel considered the main areas of focus of our Mortgages Market Study to be generally appropriate. It believes it is important not just to focus on price as a metric. It encouraged us to develop measures of customer satisfaction which go beyond the cheapest option to establish a realistic view of whether the customer has made the right decision.

Our response

Our Mortgages Market Study found that the mortgage market works well in many respects. Engagement is high and consumers are getting mortgages that are suitable and affordable. But it could also work better in other ways. There are limitations to the effectiveness of the information and tools available to consumers. This means many consumers miss out on cheaper deals that are just as suitable.

As the panels rightly identified, there are concern about consumers, commonly referred to as mortgage prisoners, who are currently unable to switch.

We have published a Policy Statement which sets out the changes we are making to our responsible mortgage lending rules and guidance. These changes will enable lenders to undertake more proportionate affordability assessments for consumers looking to move to a more affordable mortgage without borrowing more. To ensure these customers are made aware of this change, inactive lenders and administrators of entities not authorised for mortgage lending will be required to review their customer books to identify and contact eligible customers.

Duty of care

The Consumer Panel, Practitioner Panel and Smaller Business Practitioner Panel all commented how they had been working together with us on the way forward to a Duty of Care.

The Consumer Panel commented they were pleased to see us publish our Discussion Paper on a duty of care and potential alternative approaches. They acknowledged that the challenge is not an easy one and look forward to continued engagement over the coming year. They cautioned that they hoped Brexit would not delay progress.

Both the Smaller Business Practitioner Panel and the Practitioner Panel commented that they are seeking a way forward on a Duty of Care which works for consumers, practitioners and the regulator. The Practitioner Panel focused on how regulators can encourage firms to 'do the right thing' in terms of fairness, without running the risk of becoming uncompetitive.

Our response

In April 2019 we published a Feedback Statement summarising the responses received to our Discussion Paper (DP), 'A duty of care and potential alternative approaches', and setting out next steps.

We have analysed the feedback received and identified potential options for change that are most likely to address deficiencies in consumer protection. These are:

- reviewing how we apply the regulatory framework – in particular, the application of 'the Principles' in our authorisations, supervisory and enforcement work and how transparent we are with firms about this
- new/revised Principles to strengthen and clarify firms' duties to consumers, including considering a potential private right of action for Principles breaches

Fair pricing

The Practitioner Panel and the Smaller Business Practitioner Panel responded jointly to our Discussion Paper on fair pricing. Their key messages are that we should start from a point of 'what is the right exchange of value' between the customer and the firm, considering all costs and benefits of the product over time, to establish a fair price. They believe it is not in itself unfair that different customers pay different prices for the same product and more work needs to be done on articulating the degree of differential value and what is and is not acceptable.

The Practitioner Panel acknowledged there are pricing practices within the industry which are not fair, and that this needs to be addressed. It suggested we can make the most difference in markets in a sub-optimal position on some products such as current account pricing.

The Consumer Panel welcomed our Discussion Paper and called for us to take more robust and swift action against unfair pricing practices when they arise. It also welcomed our recognition that consumers incur search costs in lost time and effort, and that these should be considered.

The Consumer Panel have commissioned their own research into automatic upgrades, that automatically move consumers holding poorly performing or poor value financial products onto better, comparable products within the company's suite of products. The aim of the research is to help understand how a policy of automatic upgrades might affect different segments of the population.

Our response

The fair treatment of existing customers is an ongoing priority for us and as part of this work, we're focusing on the fairness of pricing and tackling the potential harm caused by certain pricing practices.

Our Discussion Paper launched a debate on the fairness of certain pricing practices in financial services. The debate focused on:

- firms charging different prices to different consumers based solely on differences in consumers' price sensitivity ('price discrimination')
- firms charging existing customers higher prices than new customers (sometimes referred to as 'loyalty pricing' or 'inertia pricing')

We recognise these practices are not always unfair, but have concerns that in some forms they can potentially disadvantage some consumers significantly, such as the most vulnerable and least resilient consumers.

Our work on fair pricing is continuing. We will apply our thinking to issues we identify in our market specific work. The first application of the framework is the General Insurance Pricing Practices Market Study. We published our interim findings in October 2019.

Our findings show that these markets are not working well for consumers. Firms use complex pricing practices that allow them to raise prices for consumers that renew with them year on year. This is called price walking and the fact firms do this is not made clear to consumers.

Industry has acknowledged the need to tackle concerns about pricing practices and has been taking some steps to do this. However, we think that our intervention is also likely to be required.

We will also begin the work required to formally embed our thinking into our regulatory approach. As part of this work we will be contributing to the review of our Principles, which will be the first strand of our Handbook Review.

As set out in our Business Plan, we intend to publish a Discussion Paper on the review of our Principles in Q4 2019/20. We will report on the next phase of our fair pricing work at that time. We will continue to work closely with the panels throughout this period.

3 Key specific issues raised by the panels

This section identifies and responds to some of the issues raised by individual panels. We have not attempted to respond to every issue, but to some of those we see as important to the panels and those they represent.

Financial Services Consumer Panel

Protection gap

In its Discussion Paper and subsequent workshop with stakeholders, the panel called for us to give mortgage lenders and intermediaries direction as to whether they should talk to borrowers about the impact of a lost or reduced income, as well as considering whether a borrower's ability to withstand a sudden or prolonged drop in income should be part of a mortgage assessment.

Our response

The changes we are making following the Mortgage Market Study will give consumers more choice as to how they buy a mortgage and more information to help them choose between intermediaries. The aim is to remove obstacles to consumers transacting. While income protection can be an important way of providing household resilience against shocks it is not the only means, and an obligation to consider it in every sale would increase transaction costs and potentially act as a disincentive for switching.

Firms are free to highlight the importance of protection issues during a mortgage sale, and promote their ability to assist further with this. The proposed development of a 'broker choice' tool, as a market study remedy to help consumers make a more informed choice about who they use, may be a means for promoting the availability of this support.

Our rules already provide a degree of reassurance as to the ability of the borrower to make future payments due to the requirement for affordability to be stressed at a higher interest rate. This stress testing is broadly supported by both lenders and consumer representatives even though it inevitably represents a constraint on access to mortgages. Introducing further criteria to guard against the impact of uncertain events, such as job losses, would significantly magnify this constraining effect.

Consumer Credit

The panel continued to call for us to adopt a holistic approach to the consumer credit market and set out a vision for what a well-functioning credit market would look like for consumers.

They expressed concerns regarding guarantor loans and the potential for consumer harm. They commented that action in other areas of high-cost credit has led to increased take up of a different product.

In relation to our High-Cost Credit Review they said there was evidence of poor practice among some newly authorised lenders. They called for us to:

- take bold action where we have evidence of consumer harm
- review our Threshold Conditions to ensure that consumers are protected from irresponsible lending practices
- review how well the Authorisations gateway is working especially when there are large volumes of applicant firms

In relation to overdrafts they called for us to examine firms' pricing strategies and ensure overdraft fees and charges were not exploiting consumers in financial difficulty with charges that far exceeded the marginal cost.

Our response

Credit allows consumers to spread payments to meet their immediate needs. We expect creditworthy consumers to be able to access products that meet their needs and to be treated fairly if they're in financial difficulty. To determine whether markets are functioning well, we conduct annual analysis of the sectors we regulate through sector views, which identify harm and the drivers of that harm.

This analysis is published annually. We use it to target interventions to reduce harm caused by markets not working.

Our review of high-cost credit identified significant harm to consumers using high-cost credit, many of whom are vulnerable. As a result, we have implemented wide-ranging reforms of the rent-to-own market, catalogue credit and store cards, buy-now-pay later offers, home-collected credit and overdraft markets.

Recognising that not all consumers will have access to mainstream credit, we have published our Alternatives to high-cost credit report setting out actions and recommendations to improve the availability and awareness of alternatives to high-cost credit. The report provides an update on our approach and the key issues we identified.

Our remit means we are not the most appropriate authority to address some of the challenges around alternatives to high-cost credit. Where we can make a difference to the availability or awareness of alternatives, we will do so in the ways set out. In many instances, others can take the lead more effectively. We've made a range of recommendations to other organisations. We made a commitment to continue to work with the Government providing technical expertise, in particular on its package of measures to increase consumer access to fair and affordable credit announced in the October 2018 Budget.

For guarantor loans, we know from supervisory engagement that many guarantors make at least one loan repayment and the proportion of guarantors making payments is growing. We are exploring whether this might indicate that the loan might not be affordable for the borrower. We are also seeking to establish whether potential guarantors have enough information to understand the likelihood and implications of the guarantee being enforced.

In our Policy Statement High-cost credit review: Overdrafts policy statement PS19/16 we made rules changing the way banks and building societies price overdrafts because we found charges for some people, particularly the vulnerable, were disproportionately high. Our changes come in to force on 6 April 2020 and will make overdrafts simpler, fairer, and easier to manage, protecting millions of consumers that use overdrafts. The price of each overdraft will be a simple, annual interest rate, there will be no fixed daily or monthly fees. Charges for overdrafts will now be directly related to the amounts borrowed and the length of time that consumers borrow for.

In relation to Authorisations, we use a risk tolerance framework. This guides how we prioritise our resources across many applications to give greater scrutiny to firms and business models that pose the greatest risk of harm to consumers and the market. The framework enables us to be flexible so we can respond to new and emerging issues promptly as our risk tolerance changes. We also keep our approach under constant review and have recently carried out a large-scale improvement programme. More detail can be found in Our Approach to Authorisation.

Retirement Outcomes Review

The panel supports the idea of investment pathways but highlight that the consumer journey to an active investment choice should fit into the wider decision-making process, so that consumers explore the full range of options available to them at retirement.

The panel believes that earlier and clearer 'wake-up' packs should help, and that consumers should be defaulted into Pension Wise Guidance when they look to access their pension savings, unless they opt-out.

They called for clearly presented options, free from jargon, to keep the process simple while increasing the chances of engaging consumers with how their pension savings are invested.

Our response

We have completed the second phase of policy work arising from our Retirement Outcomes Review (ROR). In July, we published final rules and guidance on investment pathways. Investment pathways are designed to help non-advised drawdown consumers who struggle to make investment decisions, by offering them four clearly presented objectives about how they plan to use their pension savings. We have also made rules to ensure that non-advised consumers entering drawdown invest wholly or predominantly in cash only if they have taken an active decision to do so. The rules on both remedies will come into force on 1 August 2020.

We will continue to monitor the market over the coming months and years to assess the effectiveness of these remedies. In our post-implementation review, (which will begin one year after investment pathways are implemented), we will look at the charges providers are applying to pathways. While these changes will be the focus of our review, we will also look at a number of other issues, such as how providers are offering investment pathways (i.e., how their choice framework operates) and how they are complying with the relevant product governance requirements.

Some of the rules from our first phase of policy work arising out of the ROR come into force in November 2019. These include requiring earlier and clearer 'wake-up' packs which will now have to be provided from age 50. Our changes are aimed at making 'wake-up' packs more effective, so that it is easier for customers to understand and decide between the options available to them when accessing their pension savings.

Finally, the Financial Guidance and Claims Act 2018 (The Act) requires us to make rules providing that, as part of the application process from a consumer to access their pension savings or transfer any rights accrued under their scheme, firms must ensure that the consumer is referred to appropriate pension guidance, and that they are provided with an explanation of the nature and purpose of that guidance. The Act also requires our rules to set out that, before proceeding with an application to access or transfer a consumer's pension savings, firms must ensure the consumer has either received appropriate pensions guidance or opted-out. The Act gives us the discretion in certain areas. For example it says we may make rules about how and to whom, a consumer indicates they have received or opted-out of pensions guidance.

It also requires us to consult with the Money and Pension Service (MaPS) and the Secretary of State before consulting on rule changes. We're currently working closely with MaPS, The Pensions Regulator and the Department for Work and Pensions on testing approaches.

MaPS are working with the Behavioural Insights Team (BIT), who specialise in generating and applying behavioural insights to public policy. In October the BIT began testing two different approaches to directing savers towards Pension Wise guidance when they first seek to access their pension savings. The trial is being conducted with customers of three participating firms. These are Aviva, Hargreaves Lansdowne and Legal and General.

The results of these trials will help inform our approach to the rules, which we will then consult on.

Basic savings rate

In response to our Discussion Paper- Price discrimination in the cash savings market, the panel said that while a basic savings rate may result in banks offering better rates to long-standing customers. However, it may lead to loyal customers all being paid the same rate resulting in virtually all customers having to switch every one of their savings accounts each year in order to receive the best rate on offer. They urged us to examine the option of a rule requiring banks to automatically upgrade consumers, to limit the number of instant-access saving accounts and cash ISAs offered by a single provider.

Our response

In our Business Plan, we set out our cross-sector priorities, which include proposals for tackling price discrimination in cash savings, assessing the role and impact of 'open finance' and considering the role of a duty of care in our future approach to regulation.

We are currently considering the responses to our Discussion Paper in this context, and we intend to publish either a consultation paper or feedback statement in the near future which will outline the feedback received and our next steps. We also met with the Consumer Panel in July this year to discuss our latest thinking following the feedback from the DP.

Data

The Consumer Panel commissioned the London School of Economics to investigate how consumers who already use third-party providers share transactional financial data, whether they give informed consent and their attitudes to sharing data. Following this they recommended that we:

- ensure regulation keeps pace with technological advances
- require all firms using consumers' payments data to have ethics committees
- test possible mechanisms by which third-party providers can tell consumers in real time when they plan to share or sell their data

Our response

We recognise that to meet our objectives we must be able to respond to technological change. and many of these issues are addressed in our Business Plan. Governance and accountability arrangements for algorithmic decision-making are included as part of our Business Plan priority on 'data, innovation and data ethics'.

In so doing we need to be mindful of the broader context, including the role of the Information Commissioner Office (ICO) in regulating data and privacy in the UK. The ICO's forthcoming publications on Artificial Intelligence (AI) explainability and AI auditability will provide important frameworks for the use of algorithmic decision-making as well as the use of personal data – including in financial services.

We are running a joint project with the Alan Turing Institute on AI transparency looking at the ethics of AI in financial services, with a particular focus on AI transparency and AI explainability. The findings of the joint project, which is due to be completed in summer 2020, will feed into our future policy work.

We have also recently completed a joint survey with the Bank on the application of machine learning in UK financial markets. The survey showed firms have an incomplete understanding of the role of ethics when it comes to data and we are now considering how this can be best addressed.

The FCA Practitioner Panel

Communication of success metrics

The Panel commented that it would be helpful if there was a more explicit communication of our success metrics both for supervision and enforcement, and particularly in the case of enforcement, measurement of the benefits achieved by intervention.

Our response

Evaluating the impact of our work is a critical part of getting our interventions right and helping us improve our performance. However, while we evaluate our supervisory activities regularly, the results of this work cannot always be published as this may undermine market integrity or effectiveness of our future work. Statutory constraints also mean that in many cases our firm specific work must remain confidential.

For firms with the greatest potential impact on consumers and markets we perform regular firm evaluations which include effectiveness of the supervisory work undertaken and this determines our supervisory strategy and future work programme. All other firms are supervised as part of a portfolio of firms with similar business models. We hold regular strategy forums for each portfolio where we review and evaluate the work which has been done, identify areas to focus on and set the supervisory strategy for the portfolio.

We publish our Enforcement Annual Performance Report which evaluates our approach to enforcement and measures our performance. We take several factors into account in assessing whether we have acted effectively and added public value, including a range of delivered outcomes.

At an organisation level, our Mission outlines how we will test the effectiveness of our remedies to help us make better decisions and add more public value. We are looking at what a more outcomes based regulation could look like in practice and the benefits it could deliver to market participants. In order to drive this debate, we will engage with our key stakeholders including the panels, the regulatory community, consumer groups, industry stakeholders and government to ensure financial services regulation continues to serve the public interest.

Future of Regulation

The Panel commented that legislation and regulation that changes multiple times during the lifecycle of a product (often with a duration of many decades) do not serve either the customer or the industry well. Likewise, environmental, social and governance issues should be considered over the long term, rather than short-term.

Our response

We operate in a rapidly changing political, economic, technological and social landscape. As the UK financial services sector looks beyond EU withdrawal we need to ensure that our regulation keeps pace with the needs of consumers and industry, while providing consistency and coherence.

We are using the opportunity of the UK's exit from the EU to consider the future of regulation and how best to deliver in the public interest in this changing context. The Future of Regulation project is our key programme for delivering good outcomes for consumers and users of financial services in a challenging future environment.

On 21 October 2019, Christopher Woolard, Executive Director of Strategy and Competition at the FCA, delivered a speech at the City of London / Cicero event on Future of Regulation. He spoke about how we are asking ourselves if our regulatory model is still the right one, and if it's ready to respond to the changes we can foresee. He also spoke of how we will be issuing an open invitation to the industry on their thoughts and ideas on the future of its regulation. We have already begun to engage with the panels on this work and look forward to their continuing involvement over the months and years ahead.

Evaluation of FCA work

The panel noted the significant number of consultations we have undertaken over the last year. In addition, there were several sizeable data requests including those relating to the Investment Platforms Market Study and the Strategic Review of Retail Banking Business Models. Responding to these requests continued to be a resource-intensive exercise for firms facing several challenges. It therefore welcomed the Discussion Paper on the Ex-post-Impact evaluation framework.

It encouraged us to go further than looking at individual initiatives and consider the totality of our interventions, as the cumulative impact is key to firm's ability to respond. It also recommended the process would benefit from external oversight and challenge.

Our response

We are aware of the costs our regulation imposes. Any proposal we make to extend or alter our rules must be accompanied by a cost benefit analysis that considers the likely costs and benefits to those affected. We also annually report on the burden we impose on business as part of our Enterprise Act obligations.

We have commissioned a specific piece of work on the regulatory costs borne by small authorised firms. This is part of a wider consideration of the impact of our regulation. We do not only assess the likely impact of our proposed regulations, but also evaluate their impact after they have been implemented. In December 2018, we published the final Ex-post Impact evaluation framework together with the Feedback statement to our Discussion paper.

We will continue to consider the impact our interventions have on firms and consumers. Since publishing our evaluation of our guaranteed asset protection intervention in July 2018, we have published three further evaluation papers:

- an evaluation of bringing additional benchmarks into the regulatory and supervisory regime
- an evaluation of reducing barriers to entry into the UK banking sector and,
- most recently, an evaluation of our general insurance renewal transparency intervention

Pensions

In relation to the joint FCA and TPR pension strategy, the panel urged both us and TPR to be clear in our strategy as to what the biggest risks are and link our interventions to these risks, to avoid minor changes that have little effect. The panel is particularly concerned with any actions which would reduce access to advice for people making longterm decisions. They called for advisers to be remunerated for taking on risk which can extend beyond the lifetime of the client.

On pension transfers, the panel encouraged us to focus on:

- identifying and preventing poor practice among a minority of advisers
- identifying differences in approach between employer-sponsored schemes and another model
- developing an innovative approach to triage services refining who needs to take advice, rather than setting an arbitrary threshold

Our response

In October 2018 we, along with TPR, launched our joint regulatory strategy ('the Strategy)'. This is aimed at strengthening our relationship, and taking joint action to deliver better outcomes for pension savers and those entering retirement, including improving member/consumer outcomes from DB transfers.

The Strategy identifies key issues which contribute to the prospect of people not having adequate income or the level of income they expected, in retirement and links our interventions with the issues identified.

As part of this Strategy we published Consultation Paper CP19/25: Pension transfer advice: contingent charging and other proposed changes (CP).

This CP sets out proposed measures to change how advisers deliver pension transfer and conversion advice, particularly for defined benefit (DB) to defined contribution (DC) transfers and conversions. We are consulting on banning contingent charging and are including a 'carve out' for consumers with certain circumstances, to maintain access to advice for those who could most benefit from a transfer. We are also proposing a new short form of advice ('abridged advice') that will be exempt from the ban and will help filter-out those consumers who are unlikely to be suitable for a transfer, before they pay for full advice.

In addition to this we are consulting on a package of proposals that covers all types of advice provision (including employer-sponsored exercises) including:

- remedies intended to improve consumer engagement with the advice process (for example, improving charges disclosure and prioritising a client's existing workplace pension as a destination for a transfer)
- more guidance for firms on how to deliver triage services
- the collection of data to let us focus resources on firms most likely to cause harm

We look forward to continued engagement with the panel throughout and beyond the consultation period.

The FCA Smaller Business Practitioner Panel

Costs and benefits of regulation

The panel supports our work identifying and monitoring the cost of regulation for smaller firms. But they emphasised the need for us to consider both the layering of multiple regulatory initiatives and the opportunity cost in terms of activities missed or postponed i.e., for smaller firms increased regulatory activity results in less client-facing, fee-earning activity, fewer resources available for innovation or less participation in industry events.

Our response

One of our priority outcomes of The Future of Regulation Project is that good outcomes continue to be delivered in a challenging future environment. Where possible, we intend to streamline the impact and costs of regulation to UK financial services, including through better coordination with other relevant regulators.

In doing this we plan to consider the costs of regulation. A measure of this will be our success in streamlining our communications and engagement with other regulators, so that firms are receiving fewer contradictory or overlapping messages and our interventions are better coordinated.

We have begun to engage with the panels on this work and look forward to their future involvement.

We have also commissioned a specific piece of work on regulatory costs for small firms. This work aims to improve our understanding of how and why regulatory costs arise for smaller firms, and what the major areas of concern are. This is part of a wider consideration of the impact of our regulation. The findings of the work will also contribute to our review of our Handbook.

Authorisations

The panel commented that it can still take some time for Authorisations to approve senior managers, especially for dual-regulated firms which also require approval from the PRA.

It encouraged us to work actively with the Financial Ombudsman Service 'the ombudsman service' and the Financial Services Compensation Scheme (FSCS) to reduce the instances of phoenixing firms.

Our response

Our statutory service level for approved person applications is 90 days. We meet this in more than 99.5% of cases.

Occupying a senior manager role in financial services is a very important position which requires appropriate scrutiny. When firms are looking to appoint senior people, they should try wherever possible to allow sufficient time in their recruitment timetable for such approval.

Very often firms may be able to integrate this with notice periods when new employees are taking up roles. Applicant firms can also assist the speed of approval by ensuring they have undertaken thorough due diligence and have been thorough and open in disclosing all relevant material at the outset of the application. We meet regularly with the PRA to discuss how we work together where we have shared responsibility for assessments.

In May 2019, we launched a working group to tackle the ongoing issue of phoenixing in financial services. Phoenixing is when a new company is created to continue the business of a company that has been deliberately liquidated to avoid paying its debts, including taxes, creditors and employee entitlements.

We have held a round-table event which was attended by representatives of the FSCS, the Ombudsman Service, the Insolvency Service and Scotland's Accountant in Bankruptcy.

While we have previously shared information with these partners, this is the first time we have come together in a formal way to discuss and agree how to work together more closely in the future.

Sharing data on issues such as FSCS claims, complaints, unpaid Financial Ombudsman Service awards and director disqualifications is proving highly effective in preventing and detecting instances of phoenixing and in helping us build cases to refuse applications for authorisation.

Directory

The panel raised concerns about the implications for advisers not included in the Directory, such as advisers offering protection products. It called on us to make clear that such advisers are not excluded from the Directory because they are carrying out fraudulent activity or have been subject to enforcement.

Our response

We acknowledge the panel's concerns regarding advisers not included within the Directory and how this may be interpreted. The Directory's interface is currently being designed and we have fed these comments in for consideration.

FCA Markets Practitioner Panel

LIBOR transition

The panel encouraged us not to indicate the end of the London Interface Offered Rate (LIBOR) at this stage, as such an approach would present substantial legal risks that outweighed the potential benefits of providing clarity to the market and incentivising the transition. They advised us to engage closely with our US and other counterparts to ensure that a consistent international approach is taken in the main jurisdictions.

Our response

While we recognise the difficult issues of legacy LIBOR contracts, the interest rate benchmark LIBOR is expected to end after 2021 and firms must transition to alternative rates before this date.

Authorities cannot provide any certainty that LIBOR will be available after this date and we expect firms to progress towards reducing their LIBOR exposure and managing risks associated with transition.

In September 2018, we sent a joint Dear CEO letter with the PRA to major banks and insurers supervised in the UK. We asked for details of the preparations and actions they are taking to manage the transition from LIBOR to alternative interest rate benchmarks. We encourage all firms who currently rely on LIBOR to read, reflect and act on the Dear CEO letter and feedback.

Alongside the Bank, we are working closely with market users to support the transition away from LIBOR in sterling markets, particularly through the Working Group on Sterling Risk Free Reference rates. This Working Group recommended a reformed version of the Sterling Overnight Index Average (SONIA) benchmark as its preferred near Risk Free Rate (RFR) for sterling markets.

SONIA offers a robust alternative to LIBOR and provides many advantages to borrowers.

Compounded SONIA, which is used in most contracts rather than SONIA itself, provides a less volatile rate compared to LIBOR by design. Because of this, the 3 month (for instance) compounded SONIA rate is predictable. This is due to the calculation each day dropping one day's rate and adding another day's rate, and so any move in the overnight rate whether it be permanent or temporary is smoothed

There is virtually no credit risk premium embedded into the rate. During times of market stress this is beneficial to borrowers. This differs to LIBOR, which incorporates the banks credit premium into the rate. Data shows us that banks rarely borrow themselves in 3 months any more, they are far more likely to borrow either in the overnight or in the longer term (beyond 2 years).

We do recognise, however that LIBOR is a forward-looking rate while compounded SONIA is a backward-looking rate and that some borrowers may prefer to know their interest in advance.

We have been engaging closely with US and other counterparts and this engagement is ongoing. The Financial Stability Board's Official Sector Steering Group (OSSG) coordinates international efforts on benchmark reform and the transition from LIBOR. The International Swaps and Derivatives Association (ISDA) is leading work to enhance the robustness of derivatives contracts referencing widely-used benchmarks, such as LIBOR. ISDA has consulted on how best to calculate fair replacement rates for LIBOR in sterling, Swiss franc, Japanese yen and US dollars.

We also chair the Taskforce on Financial Benchmarks, which is part of the International Organization of Securities Commission's. This taskforce considers a range of benchmark-related issues, including the transition away from LIBOR.

Additionally, the Financial Policy Committee (FPC) is engaged in the transition from LIBOR to RFRs. Further details can be found in the Financial Stability Reports.

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