Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

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Dear Sir / Madam,

Financial Services Consumer Panel response to FCA consultation on Capital deductions for redress: personal investment firms

The Financial Services Consumer Panel (the Panel) welcomes the opportunity to respond to the FCA's consultation on capital deductions for redress: personal investment firms.

The Panel are supportive of the FCA's intervention in this market and would like to see similar approaches applied across other areas where firms causing the most detriment are not shouldering an appropriate proportion of their costs. As a first step, the Panel agrees that the FCA should apply these rules to all activities that are categorised as designated investment business and ancillary activities connected with designated investment business for which personal investment firms (PIFs) are liable, as these are not covered by the prudential regime for MiFID investment firms.

The main area of concern for the Panel is the use of a market average in determining the minimum probability factor at 28%. The Panel is of the view, supported by the fact that 95% of the FSCS redress in this area was caused by 75 firms, that where a firm has a problem that this will impact significantly more of their business than 28% and it is not in the firm's own interest to set a higher factor. The Panel would therefore wish to see more analysis into the 75 firms and that this analysis is used to create an approach to the setting of the probability factors at a more useful firm-level, as opposed to the blunt instrument of the currently proposed 'market average'.

The Panel would therefore expect and encourage the FCA to monitor the effectiveness of this intervention and consider other markets where this may be useful.

Please see response to questions in Annex A, below.

Yours sincerely,

Helen Charlton

Chair, Financial Services Consumer Panel

Annex A – Response to consultation questions

Q1: Do you agree we should only apply these rules to all activities that are categorised as designated investment business and ancillary activities connected with designated investment business, and for which PIFs are liable?

The Panel agrees that as a first step the FCA should only apply these rules to all activities that are categorised as designated investment business and ancillary activities connected with designated investment business, for which PIFs are liable as these are not covered by the prudential regime for MiFID investment firms. The Panel would expect the FCA to monitor the effectiveness of this intervention and consider other markets where this may be beneficial.

Q2: Do you agree we should exempt PIFs subject to consolidated supervision under MIFIDPRU or the CRR, or group supervision under SII, and which benefit from group risk assessment? Should PIFs have to notify us that they are proposing to make use of the exemption?

The Panel doesn't object to the exemption as outlined, however the Panel would propose that PIFs should notify the FCA that they are proposing to make use of the exemption, and then reconfirm this, or otherwise, on an annual basis.

Q3: Do you agree with the scope of potential redress liabilities?

Yes, the Panel agrees with the scope of the potential redress liabilities.

Clearly the identification of prospective redress liabilities will have a degree of subjectivity in their calculation. We would therefore expect the FCA to review how this area of the regulation is working across the market to ensure it is effective, and we would also expect Supervision to review these for specific identified firms as required.

Q4: Do you agree with our proposal not to place new requirements on PIFs to proactively uncover potential redress liabilities in their past business and instead rely on existing monitoring requirements?

The Panel has no objection to this approach so long as the FCA is confident that existing monitoring requirements will adequately identify prospective redress liabilities (especially those linked to recurring or systemic problems) as outlined in 3.13.

The Panel assumes that should an industry-wide issue be identified that the existing monitoring requirements would identify all associated redress liabilities.

Q5: Do you agree with our proposal for PIFs to hold capital resources until a potential redress liability has been resolved and there is no realistic prospect of it being reopened?

The Panel agrees with the approach outlined.

Q6: Do you agree PIFs should estimate the amount of funds they may need to provide redress and we should not mandate a single or tiered redress figure in our rules?

The Panel agrees with the approach proposed. However, the Panel would expect the following:

- Tighter rules to be developed to cover the process by which PII insurance cover is calculated and used to reduce the estimate of redress. The Panel questions

whether the PII cover (both eligibility and amount) needs to be specifically confirmed by the insurer before it can be used in the calculation
- The FCA to monitor a firm's estimates and final amount of funds used in redress and, if required, instruct firms to use a different calculation approach

Q7: Do you agree we should allow PIFs to reduce the redress amount per customer where PII applies and that we should not mandate a maximum PII offset in our rules?

Yes – however the Panel would expect to see rules around how the extent of the PII cover is decided and agreed (See Q6).

Q8: Do you have any views on the likely impact of these rules on individual PIFs' PII policies or the PII market as a whole?

No response.

Q9: Do you agree we should allow PIFs to reduce their potential redress liabilities by applying a probability factor to both their unresolved and prospective redress liabilities?

The Panel does not object to this approach so long as the probability factor is well thought through, reflects both the history of a firm's redress payments and a reasonable assessment of the same going forward.

The key outcome the Panel wishes to see is that consumers are more protected and are less likely to need to call on the FSCS for redress payments, with the potential that their losses above the £85k limit are unrecoverable.

For clarity, the Panel does not agree with the proposed probability factor.

Q10: Do you agree we should prescribe the minimum probability factor using our data on uphold rates?

The Panel agrees that the FCA should prescribe a minimum probability factor, however we believe that this 'backstop' should not be used as commonplace, and that firms should evaluate the likely potential for each redress case individually, report this figure and be assessed in its accuracy by the FCA, who should instruct the firm to change their methodology as required, based on historic performance of this calculation. This will ensure that firms have a specific incentive, beyond the generalities of the Consumer Duty, to improve the quality of advice they give to their customers.

Q11: Do you have any views on how we have reached the probability factor of 0.28?

The Panel does not agree with this level of probability factor or the means by which it has been decided.

Our concern is that as 75 firms were responsible for 95% of the total redress paid, applying a market average of 28% does not reflect the fact that some firms (potentially those similar to the 75) will experience 100% of identified cases being paid redress.

We do not, therefore, believe that a market average is of any meaningful use in this process.

The Panel would expect the FCA to have performed a deep analysis of the 75 firms and applied this understanding and insight to the process to develop a better approach and probability factor, rather than using a market average. Different insights will be obtained depending on whether the consumer detriment was due to 'bad actors' versus other issues.

Firstly, the Panel would prefer to see a higher minimum, based on the insight of the 75 firms, with the ability for firms to request a waiver to reduce the factor below this minimum as outlined in 3.44. Firms that have performed well in complaint handling, and probability calculation would be more likely to receive such a waiver. This would also incentivise firms to seek improvements in the quality of advice they provide to their customers.

Secondly, over time, we would expect the FCA to monitor the accuracy of a firm's initial calculation of the probability of redress compared to the actual outcome and start to apply either individual firm level minimums, or firm level 'loading' on a single (market wide) minimum. This would benefit those firms who have a low redress case ratio (as a proportion of complaints) and ensure that those firms that either have a high proportion of cases needing redress payments, or that have historically under-estimated the probability, will be required to hold a higher capital proportion against total redress liabilities. This would also mitigate against the issue that the proposals rely on self-governance by firms, which raises particular concerns about 'bad actors'.

The key concern of the Panel is that consumers receive the full amount of any redress to which they are entitled. We believe an approach such as that outlined above gets closer to achieving this and starts to move the market more toward a polluter-pays model.

Q12: Do you agree with our approach to deduct potential redress liabilities from PIFs' calculation of their capital resources under IPRU-INV 13.15?

Yes.

Q13: Do you agree with our proposal to implement the deduction via a change to PIFs' regular financial reporting in the Retail Mediation Activities Return (RMAR)? If not, please say why and what alternatives you think are appropriate.

The Panel are comfortable with this approach however note the statement in 3.53 that the FCA expects firms to 'notify us immediately, as required by SUP 15, if they find they are breaching capital requirements between reporting cycles'.

Q14: Do you have any views on the alternative of implementing this reporting via ad-hoc reporting?

No response

Q15: Do you agree that we should impose an asset retention requirement on PIFs that do not have sufficient capital resources (after applying the deduction for redress) to meet their minimum regulatory capital requirements?

The Panel agrees with this approach but would make the following comments:

1. Where a firm does not have sufficient capital, we would not only expect an asset retention requirement to be imposed, but also consideration to be made as to whether the firm needs to add to its capital to bring this up to the required level.
2. Where a firm does not have sufficient capital, we would expect the FCA to review any previous and recent, capital withdrawals to ensure that capital has not been removed in advance of redress liabilities being calculated. Where this is proved to be the case, the Panel would expect the FCA to act quickly in securing assets to replace the withdrawn capital.

Q16: Do you agree that this should include circumstances where a PIF is not meeting its minimum capital requirements and has provisioned for liabilities in its financial statements?

Yes.

Q17: Do you agree with our proposal to publish information about which PIFs are subject to an asset retention requirement on the FS register?

The Panel supports this and believes it is an important step. Where consumers are including the Financial Services (FS) Register in their due diligence activities around the firm they choose to engage, it is important that the consumer is aware if the firm has problems holding the required capital to ensure effective consumer redress to take place.

The Panel also believes that the FCA should ensure that the register is accessible, easy to navigate, easily understandable and jargon-free.

Q18: Do you agree with the proposed exclusions to the asset retention requirement?

The Panel believes it is important that where a firm is excluded from the asset retention rules, that it is clear to a consumer that this is the case. This should be clear and easy to find on the FS Register, additionally we would expect excluded firms to be required to discuss this to new customers as part of their engagement process.

Consumers should be made aware of the reason for the exclusion and what this could mean for them in the event of a complaint against, and redress from, the firm.

The Panel also believes that the FCA should ensure that the register is accessible, easy to navigate, easily understandable and jargon-free.

Q19: Do you agree with the proposed methods for the application of the asset retention requirement and the proposed notification requirements?

The Panel agrees with the approach and emphasises the importance of follow-up actions where a firm fails to comply to ensure that consumers are protected, and that the regulation remains credible.

As in our response to Q15 - where a firm does not have sufficient capital, we would expect the FCA to review any previous and recent, capital withdrawals to ensure that capital has not been removed in advance of redress liabilities being calculated. Where this is proved to be the case, we would expect the FCA to act quickly in securing assets to replace the withdrawn capital and in taking action against the individuals concerned.

Q20: Do you agree with our proposals for the remediation plan?

Yes.

Q21: Do you agree with our proposed rules for transactions in or outside the ordinary course of business?

Yes.

Q22: Do you agree with our proposal to require PIFs to notify us at least 20 business days in advance (or with as much advance notice as possible in urgent situations) for transactions that they consider to be in the ordinary course of business but which are not listed in our rules, and for new or amended contracts with a connected person which may result in new or increased payments above the Consumer Price Index rate of inflation?

Yes, however the Panel would expect the FCA to pay particular focus to payments of dividends that remunerate natural persons. The Panel is concerned that these payments often go to firm owners, directors, partners or people covered by the SMF regime and could be used as a way to extract capital from the firm, at the expense of consumer protection. The Panel believes that such payments need to be carefully examined before payment is permitted.

Q23: Do you agree with our proposals for lifting the asset retention requirement?

The Panel largely agrees with the proposals. However, where the FCA request further information (3.90) the Panel would propose that the Retention Requirement should continue to apply until actively removed by the FCA, rather than the 20-day counter being reset.

Q24: Do you agree with our proposed implementation period?

Yes.