

Position Paper on Brexit

Introduction

The vote to leave the European Union will have significant implications for the financial services industry. Much of current UK financial services legislation emanates from the EU. Unravelling that will be a complicated business and presents both opportunity and threat to UK financial services consumers. How can we ensure that what transpires is in their interests and we retain those protections that matter most? Furthermore, how can we improve on some of those areas that are perhaps less than satisfactory and come up with a better deal for the UK consumer? Much of the Brexit commentary on financial services to date has focused on firms and what they want. The Financial Services Consumer Panel wanted to look at what Brexit could mean for the financial services consumer.

We therefore commissioned a review of the current position¹ to inform the debate on the future framework of the UK's financial services regulation in light of Brexit.

You can find the paper [here](#).

Opportunities and Risks of Brexit for financial services consumers

The UK is a global leader in financial services and its regulation. The UK has worked hard in Europe to bring about good outcomes for the UK but in negotiations with other countries it has had occasion to compromise on its position.

If the UK takes some or complete control of its financial services legislation there is an opportunity for strengthening financial services markets by addressing shortcomings in EU measures to help mould a regulatory regime which delivers better outcomes for consumers, in line with the FCA's statutory objectives.

It is likely there will be a political drive for a deregulatory agenda to curb Brussels "red tape". This could endanger some of the key protections that came about as a result of EU membership. But it could also give the UK an opportunity to get rid of legislation that is preventing markets working better for consumers.

The relationship between Government and FCA is important in this regard. Where before Government could argue that any EU legislation had to be

¹ The research was commissioned in 2016 prior to the statements from the Prime Minister and others in January 2017 which indicated a change in position.

implemented and the FCA had to do so, whether it agreed with it or not, now that 'buffer' has gone. Government and FCA will need to have a clear and shared perspective on the regulatory outcomes they are looking to achieve for consumers.

Looking ahead, in a post-Brexit world, it is likely that the UK's legislative framework will start diverging from the EU's.

To maintain its global competitive leadership position the UK could compromise on consumer protection. However, it should aspire to continue being a leader in consumer protection, keeping pace with changes brought by technology and innovation. It would be a bad outcome if the EU had more effective protection than consumers in the UK, both for consumers themselves and for levels of trust in the industry.

Which opportunities and risks will be realised will very much depend on the UK's political choices and may not be immediately visible. But the Panel hopes that the UK Government will see this as an opportunity to improve outcomes for consumers and enable the regulator to be as effective as possible.

Findings of the review

The review demonstrated that, in some areas, UK consumers have benefitted from EU membership. In others, the UK has stronger protections in place than the EU. On occasion the UK has been held back by EU legislation.

Where UK protections are stronger:

The FCA is a leading regulator in Europe. The bar for authorisations is high; there is active supervision and enforcement against firms that do not meet expectations; and consumers have free access to redress and compensation.

This contrasts with some other countries in the EU. Passported firms operating across borders differ markedly between member states, as authorisation requirements and access to compensation and redress mechanisms have not been harmonised.

Differing regimes create the possibility of regulatory arbitrage by firms i.e. firms picking the member state with most favourable authorisation requirements to obtain authorisation and sell lower quality products into the UK, putting consumers at risk.

There is some key legislation in the UK that offer consumers better protection than in the EU:

- **Redress and compensation.**
 - The Financial Ombudsman Service (FOS) is a model Alternative Dispute Resolution scheme and significant improvement is needed in EU arrangements to go as far as the UK.
 - The EU sets its current limit for the **Investor Compensation Scheme Directive** as €20,000. The UK sets its limit higher, at £50,000.
 - The UK covers **insurance company defaults through the FSCS** while the EU does not have anything comparable.

- The UK has led the way in improving protection in the **investment market**:
 - The **Retail Distribution Review** brought an end to advice paid for by commission, removing sales bias and raising the quality of advice provided to consumers.
- The UK has also been instrumental in developing rules which aim to provide the basis for sound financial markets in the EU,
 - The **Markets in Financial Instruments Directive (MIFID) II** provisions on suitability and appropriateness impose rules on intermediaries and distributors to ensure that individual consumer's circumstances are taken into account before selling a product to that consumer. The UK has also proposed to **go further** than the EU on prohibiting inducements.
 - The **Insurance Distribution Directive**, currently being implemented, includes provisions for product oversight and governance arrangements, identification of target market and conflicts of interest, which are a crucial factor in many instances of mis-selling. These mirror the sentiment of the UK's own Product Intervention Rules.

Where EU legislation has held back the UK:

In other areas of EU legislation, the UK has been prevented from providing better protection:

- The EU has been heavily focused on **disclosure**. This approach is now out of date. Overloading consumers with information can lead to poor decisions and inertia. In Amelia Fletcher's recent report into the role of demand-side remedies in driving effective competition² she concludes that "while disclosure remedies can have valuable positive impacts on consumer decision-making, there is also evidence of their being ineffective or even harmful."
- The **Financial Services Compensation Scheme (FSCS)** limit for deposits has been changed several times because of exchange rate movement as the limit set by the Deposit Guarantee Scheme is denominated in Euros. Taking back ownership of the limit would provide certainty and continuity. The EU has also failed to review the Investor Compensation Scheme Directive to strengthen consumer protection provisions.
- EU legislation has restricted the amount and types of information the FCA is able to release. Leaving the EU will enable the Treasury to review **S348** of the Financial Services and Markets Act (2000) to give the FCA legal certainty, and enable it to be much more transparent.

Where EU legislation has benefitted consumers

In general, EU legislation has benefitted UK consumers in the sense that the EU has had an overarching plan for the legislation of financial services.

Once the current block of EU legislation has been implemented there is likely to be a period of "planning blight" with the industry making the case that it should not be subject to the costs of further regulatory change so soon.

² The Role of Demand-Side Remedies in Driving Effective Competition, Centre for Competition Policy

But Brexit provides the UK with an opportunity to create its own strategy for regulation going forward.

In the immediate and foreseeable future the Great Repeal Act (also known as the EU Withdrawal Bill) will enable a review of EU legislation. Of the EU legislation currently in force, there are some key areas highlighted below that have brought clear benefit to consumers. There is also important new legislation yet to be fully implemented. And there are new initiatives on the horizon which could have an impact on consumers in the UK and which will need to be given consideration.

Existing legislation that has brought clear benefits to UK consumers which the Panel wants to see remain in force in the UK:

- On **payments**, the Payment Accounts Directive (PAD) gives consumers a legal right to a basic bank account. It also aims to improve transparency and comparability of fee information about payment accounts to make consumers more aware of the fees and charges applied by account providers such as banks.
- On **interchange fees** the European Commission introduced a cap for card transactions, which came into force at the end of 2015. Capping this fee, paid by the retailer's card acceptance provider (acquirer) to the card issuer each time a card payment transaction occurs, has generally been beneficial.
- On **collective investments**, the regulatory framework set by the framework for Undertakings for Collective Investment in Transferable Securities Directive (UCITS V) aims to increase the level of protection already offered to investors by previous versions of the Directive, by enhancing the rules on the responsibilities of depositaries and by introducing remuneration policy requirements for UCITS fund managers.
- On **credit affordability**, the Consumer Credit Directive requires creditors to assess consumers' creditworthiness before the conclusion of the credit agreement and before any significant increase in credit.
- A number of aspects of the **fair treatment of consumers** in financial services come from cross-cutting EU legislation rather than Directives and Regulations which are specific to financial services. These include: the Unfair Terms in Consumer Contracts Directive, Unfair Commercial Practices Directive and the Distance Marketing Directive (DMD).

Other important legislation under implementation the UK should keep or improve upon includes:

- **Data protection:** in May 2016 the EU published its Data Protection Regulation, which is significantly more prescriptive than the previous Directive. It introduces important provisions to protect consumers' personal data as well as greatly increased financial sanctions for businesses that fail to comply. This will become increasingly important as advances in technology radically change the way financial services markets operate.
- It is important that the Information Commissioner's Office (ICO) continues to press ahead with the swift implementation of the legislation in the UK to make sure consumer protections provided at EU level are maintained. This is especially important in light of the **Payment Services Directive 2**, also due

to be implemented by 2018, which will enable consumers to share their financial data with third parties.

Other initiatives on the horizon that could bring consumer benefit:

These include:

- **Retail Financial Services** - The EU is seeking to facilitate a single market in financial services and whether UK consumers will benefit from it will depend on the future agreement between the UK and the EU. The Green Paper published at the end of 2015 said that it sought to “improve choice, transparency and competition in retail financial services to the benefit of European consumers”.

Regardless of its focus on the single market, which may no longer be of interest to the UK, the upcoming Action Plan on retail financial services may look into important areas of consumer protection such as the definition of advice and guidance and regulation of automated advice.

Risks to consumers as a result of Brexit

Economic downturn

There is a risk of an economic downturn. Were it to happen, large numbers of consumers, many of whom carry substantial debt already, would be badly affected.

If firms’ business models need to change due to economic and environmental pressures they might withdraw or severely curtail access to products and services that previously consumers took for granted. Debts may be chased more aggressively and access to credit for SMEs may diminish even further.

Trading overseas

Consumers in countries such as the UK, with well-established compensation and dispute resolution frameworks, are already at risk if they buy products from passported firms authorised in member states with lower standards.

For UK-based consumers who already have products in the EU, it is not clear what will happen to their rights after Brexit. Similarly, it is not clear what the rights of EU-based consumers will be if they continue to hold products from the UK.

Given that the UK will be negotiating deals with third country trading partners, such as China and the US, there is also a risk that products being sold into the UK from those countries may not meet existing UK standards. Furthermore, the UK could be forced to compromise on its standards in order to secure trade deals.

Supply issues

The transition to the new post-Brexit regulatory regime may also generate supply problems for UK consumers. If non-UK firms have to apply for a new ‘passport’ to access the UK market this may well disrupt the supply of certain products and services. It may also reduce competition, therefore leading to an

increase in prices. So, the length and nature of the transitional regime is of considerable importance.

The Brexit distraction

There is a risk to existing domestic regulatory work streams and priorities that are in the consumer's interest if Brexit becomes 'the only show in town'. It could pull resources, expertise and interest away from other important initiatives in the short to mid-term that might otherwise mitigate against poor practice.

Lack of influence

EU portfolios that are already in train will still take some time to negotiate and the UK will not be directly involved in determining rules that it will be forced to comply with. It is unlikely that standards will be equivalent to the FCA regime or better in some areas, such as P2P, due to lack of UK influence.

Negotiations on Capital Markets Union (CMU) highlight some of these difficulties. There is potential for a revision of legislation currently in force and the watering down of important consumer protections. The Panel and BEUC³ have expressed concerns that consumer protection is taking a back seat in the EU's plans to push forward the Capital Markets Union. Any de-regulatory tendencies at EU level could lead to a similar impact on how the UK implements EU rules.

Good consumer outcomes post-Brexit

Given the research findings, the Panel believes that the following principles should provide a guide for what good consumer outcomes could look like:

1. Access, quality and price

- The financial services market should be inclusive so that consumers have **access** to the products and services they need.
- Consumers should get **timely, accurate and understandable information** about any financial services firm with which they deal and about any product they buy. Regulators should consumer test disclosures they mandate and should seek to ensure consumers do not get conflicting information.
- Consumers have a right to expect that a firm will assess the **appropriateness and suitability** of any investment product that it recommends or sells.
- **Costs and charges** (explicit and implicit) should be transparent and easy to understand, as should the effect these charges will have on the total price.
- Consumers should have a **right to cancel, cool-off, or pay back early** a financial product without suffering any unfair financial penalties.
- Consumers should not be subject to unfair contract terms or unfair commercial practices.

2. Robust supervision

³ Bureau europeen des unions de consommateurs

- The **authorisation and supervision** of firms should be robust to instil consumer confidence and safeguard against consumer detriment.
 - Consumers should be confident that supervisors will not hesitate to **intervene** against firms, individuals, or products should it prove necessary.
 - Regulators should ensure there are **strict controls on inducements** for firms and that firms themselves have in place remuneration policies for their own staff which safeguard against poor outcomes for consumers.
 - Consumer protection is best served by a **regulator with a consumer protection objective** which is of equal importance to its other objectives.
3. Redress and compensation as stringent as it currently is in the UK
- There should be a free to use and adequately resourced **independent body** for resolving disputes between consumers and firms and the decisions of that dispute body should be swift and **binding** on firms.
 - The industry should fund arrangements for the **payment of prompt and adequate compensation** to consumers of firms that default.

Recommendations to the regulator and government

- *Consumers should remain at 'at the heart' of negotiations on Brexit. The Brexit Select Committee should ensure it focuses on making the best of Brexit for individual consumers as well as businesses.* It is essential that the interests of UK consumers are adequately taken into account. This means ensuring that key horizontal and sectoral consumer protections that have been acquired over the years through EU membership are maintained.
- *Aligning the UK's competitiveness objectives with good consumer outcomes.* It is understandable that the UK Government will want to support the financial services industry to achieve a good competitive position post Brexit. At the same time, the Government should resist de-regulatory pressures to make the industry competitive in the short term at the expense of consumers. In the long run, both industry and consumers are best served by an effectively regulated industry.
- *Effective regulation and the FCA Mission.* As the FCA seeks to shape its Mission and clarify interpretations of consumer responsibility and the boundaries between public policy and supervision, the drive towards effective regulation should take into account future regulatory developments at EU level. This means ensuring that the FCA adheres to EU level legislation when consumer protections are stronger and cross-border regulation is more effective than having a purely national approach.
- *The transition to the new post-Brexit regulatory regime.* It is understandable that the exact details of the transitional arrangements may only become clear late in the day. However, given the issues with regards to supply of services and the impact on competition it is important that the major details of the transition are spelled out as soon as is practically possible. The length of the transition, for instance, is of particular significance.

- *Define a long-term vision and role for the UK.* Over the last 40 years, the UK has been at the heart of financial services legislation in the EU. It has acquired, within EU circles, the status of thought leader at all levels showcasing best practice in important areas of legislation in different sectors. The UK should continue to play this role to the extent possible especially in areas where consumer protections are stronger at UK level and could be strengthened at EU level.