Andrew Bailey
Chief Executive
Financial Conduct Authority
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Canary Wharf
London E14 5HS

26 January 2017

Dear Andrew,

FCA PRACTITIONER PANEL RESPONSE TO THE FCA'S MISSION CONSULTATION

I am pleased to attach the Panel's formal response to your consultation on the FCA's Mission. We have discussed the consultation with you on a number of occasions, and as you are aware we consider the exercise very welcome in thinking through a clear framework for the way the FCA operates. We were also pleased to participate in the Mission conference in November.

We have a number of general points as well as comments on the specific questions.

Trust

During the construction of the Financial Services Act 2012 which created the FCA, the Panel's FSA predecessor argued strongly for an overall objective for the new body of building trust. Although this was not explicitly incorporated into its objectives, we believe this is the foundation of good regulation and would be a powerful starting point if articulated at the start of any Mission document. Building trust between all parties would result in more consumer engagement with the industry and is a huge opportunity to align the regulator with financial services success factors.

Culture

Culture is an issue both for the regulator and for the industry – indeed, regulatory risk has become one of the biggest risks for firms. The Mission itself will be an important set of high-level guiding principles for both. The FCA should be aware of its role in leading by example to show the culture it wishes to observe in the firms it regulates, and demonstrate this culture in the actions of all levels of staff.

The converse of the trust argument is that for the FCA to empower consumers to take better decisions, it first has to trust them. This involves trusting them to know what "better" means for them, in their own lives and experiences. Unless this happens, the regulator is not empowering them to take better decisions for themselves; it is regulating them to take the decisions it thinks they should take. For this to happen, the FCA needs to focus on understanding the people it aims to protect, especially those in the most vulnerable situations. This will involve talking to them, understanding their reasoning, and better representing them by reflecting the diversity of the population in its Board management, and workforce.

Managing culture is critical in building financial services companies of the future. There is scope here for the FCA to intervene. For example, based on the work of the Women in Finance Charter it is quite clear that organisational culture is a key factor in preventing women getting to the top in financial services. But equally, we all know that better outcomes are achieved by a diverse team. Left to its own devices, the industry has not addressed this issue effectively and the Charter at least puts a reporting spotlight on to it. This is one example - there are other issues in financial services that could be addressed in this way and that the FCA should consider.

Competitiveness and competition

The Panel is particularly concerned that the consultation does not make it clear that the FCA is a supervisor for one of the largest global wholesale financial centres in the world, and that there are very few references in the document to wholesale and international markets. We understand from discussions with the FCA on this subject that this point has already been taken on board, but we believe it is an important point.

Although the competitiveness of the UK is not one of the FCA's operational objectives, the desirability of sustainable growth in the economy of the UK is a regulatory principle to which both the FCA and the PRA must have regard. We note that the Mission consultation suggests that promoting competition will enhance competitiveness, but wish to emphasise that the FCA must explicitly consider its international role, within the EU and beyond. Competition is, in this situation, necessary but not sufficient in order to comply with the principle of sustainable growth.

The Competition objective itself is the one on which the FCA has consistently achieved lower scores in the Panel's Annual Survey than on its other objectives. A specific example of a market where there is room for improvement is that of retail banking. The current landscape, incorporating free banking, means that new players cannot enter the current account world at scale and as a result customers are deprived of innovation in this important product range. We have made observations about innovation in our answers to specific questions below, but encourage the FCA to address this.

Within the context of the wider economy, the FCA needs to be aware of the way in which micro actions taken by a combination of regulatory bodies can mean that macro ambitions are frustrated. The current framework works well for systemic risks such as the market liquidity debate and asset management, and the recent property funds issue has been a good test of the system. Regulation can, however, generate quite heavy degrees of risk aversion that can have an impact on individual firms and on the system more generally. The FCA should be alert to bigger structural areas where unintended consequences of the combined actions of regulators may be arising, such as the situation which led to the creation of the New Banks Unit, and the Mission should help to clarify where it can and should take action. Overall, the FCA should always be aware of cumulative effect of regulation, from all agencies, on the industry.

We note that the consultation states that the FCA is not charged with making markets perfectly competitive, or with eliminating profit, but the Panel wishes to emphasise that the generation of profit is a key element in maintaining prudentially sound businesses, and that this needs to be explicitly taken into consideration.

Capability and financial education

Another of the regulatory principles to which the FCA must have regard is the general principle that consumers should take responsibility for their decisions. This is, however, only possible if those consumers receive the relevant information to make those decisions and the financial capability to process it. Key points of this strategy should therefore be:

- Working on reducing information requirements on firms so customers get, and can take in, the right information.
- Inputting directly into financial education which provides a clear understanding of rights and responsibilities. In conjunction with the successor to the Money Advice Service and other financial education bodies, the FCA should have input to

providing financial education for charities and NGOs to ensure they give the right advice to consumers.

- Consumers who are in danger of being financially excluded need to have access to financial services to be empowered. Financial inclusion is a key test of whether the FCA is meeting its consumer objective - consumers can only take better control of their decisions when given the chance to make them.

Capability is also important inside individual firms. It is important that the FCA highlights the importance of cyber security, and we see its role here to create centres of best practice to share learnings as this world evolves. If an area of knowledge or expertise is not a Unique Selling Proposition or competitive advantage for any single organisation then the FCA could operate a centre of excellence in this area.

Technology as a driver

Technology is a driver which redefines the nature of the relationship between the consumer and the financial services industry, and what this means for the regulator. The development of open banking in particular is an example of changing relationships. There are three aspects we consider important. The FCA needs to be asking:

- whether people are sufficiently aware of and thinking about how their data is available to third parties, such as Facebook;
- how securely is data held and transmitted;
- what does the regulatory structure need to be when third parties have the capability effectively to authorise transactions, taking into account the complexity of the relationship between end customer, third party, financial services provider and payments mechanism.

As technology redefines the nature of relationships there will be questions we cannot possibly fully foresee now and the FCA's operations must be flexible enough to deal with them when they arise.

We look forward to seeing the outputs of this consultation in due course.

Yours sincerely,

António Simões
Chair, FCA Practitioner Panel

Responses to specific questions

The Mission CP addresses a range of topics relating to the FCA's approach to financial conduct regulation. Whilst many of the discussion points and proposals appear uncontroversial, the Panel wishes to reiterate some key messages including support for the importance of culture and clear accountabilities, the need for proportionality and predictability of actions from regulators and a general aim of further simplification and stability as far as can be achieved. In particular, the following areas considered in the Mission CP are particularly important:

1.1 Use of resources / Proportionality

The consultation notes the FCA's belief that a market where consumers never make poor choices is not feasible. The Panel agrees that a well-functioning market requires engaged consumers, firms and employees that follow clear minimum standards and well-judged, timely regulation. The definition of a well-functioning financial market should not be different from that of any other type of well-functioning market, including the ability of firms to make profits in order to survive and thrive in the longer term. In this regard we agree with the FCA when it considers that the appropriate degree of protection for consumers will depend to a large extent on the capability of the consumer and the complexity of the product or service.

The Mission CP recognises that the FCA should be clearer to consumers about the degree of protection it can, and cannot, give them. This will include communicating that loss is part of well-functioning markets: consumers may lose monies, and/or firms may fail. Although we recognise the work currently underway by the FCA and HM Government to further educate consumers as to the possibility of losses from investments, we would encourage further efforts in this area.

The Mission CP discusses at length the FCA having to use judgement to decide where it can best use its resources to improve the outcomes for users of financial services, but also recognises that its judgements on the priorities for regulatory intervention can mean some users of financial services get better protection than others or that some types of harm are reduced before others. Page 14 of the consultation suggests that it may be more efficient to intervene in financial products that involve locking in over an extended period of time. Although this may turn out to be the case, it is not clear how a blanket judgement can be made regarding long-term products without considering other factors, such as investor financial capability.

The FCA proposes to use the framework provided by the Mission CP to provide more explanation of the choices it makes in pursuing its statutory objectives. The Panel supports these views on the basis that they appear to be intended to result in a more proportionate approach to financial conduct regulation which would be welcome. As a result of this we would like to see more emphasis on the FCA undertaking an overall assessment of the compounded impact of all FCA and relevant other regulatory activity on markets and firms. We would also welcome review of the split of regulated firms into fixed and flexible portfolio, and whether the current structure is appropriate or whether some middle ground is desirable.

We welcome the acknowledgment that FCA regulation exists alongside broader Government policy. Government policy can be aimed at broader societal goals across society rather than focussing on the optimal outcome at individual level. We welcome joint working between FCA and Government departments, which will be particularly important during the negotiations to leave the EU.

The consultation mentions that the FCA will measure its performance by measuring operational efficiency, the impact of its interventions and outcomes in markets. We believe the regulator should measure value for money as the net benefit to consumers from the cost of regulation and not operational efficiency. It would also be helpful for the FCA to further detail how it intends to measure the impact of its interventions and outcomes in markets, both over the short-term and the longer-term.

Related questions: Q1, 2, 3, 5, 10

1.2 Transparency of interventions

The FCA highlights that it wants to be more transparent about matters in which it chooses to intervene. It is seeking to take a consistent approach to 'diagnosing the underlying cause of harm or risk' which it is trying to address and wants to be clearer in communicating its assessment of the underlying cause of the harm it wants to prevent and the choice of regulatory tools it uses to tackle it. The FCA believes this will help it develop a clear precedent, allowing firms to understand the FCA's approach to ensuring they comply with the rules in the Handbook. The Panel supports this aspect in the hope of greater consistency, transparency and a greater predictability of outcome from the regulator. It will also help to demonstrate the FCA's independence and impartiality. We believe that the intervention framework is the correct one, though we would add that this framework should include a feedback loop on the effectiveness of any intervention and a cost/benefit/proportionality trade-off. The latter point would then help measure value for money.

We wish to emphasise that public transparency of FCA thinking and decisions can work two ways – it can enhance consumer confidence or damage it. The Panel has warned in the past that the way the media portrays FCA comment can have more impact than the comment itself. The FCA should always give consideration to implications for broader industry reputation, and how best to manage this, when making public announcements. This should include recognition of where the industry has cooperated and input positively to regulatory activity in order to help rebuild trust in the system as a whole.

We support finding alternative methods to disclosure to correct market failures in certain instances. However, we strongly encourage the FCA to carry out market testing to ensure that more interventionist methods have the appropriate results prior to requiring firms to put such methods in place. Additionally, we would like to remind the FCA of its view on not effecting price regulation when pronouncing judgement on such issues as acceptable levels of price discrimination and cross-subsidy between different consumer groups, products or services. It would be helpful here to have further clarification of its current levels of tolerance in considering price discrimination and cross-subsidy.

A further aspect of regulatory transparency is the FCA's interaction with the Financial Ombudsman Service (FOS). The FOS plays an important role in firms' response to regulatory interventions, and further alignment of the regulatory family's approach would be welcome.

We are strongly in favour of the efforts that the FCA has made to increase its support for new products, services, business models and delivery mechanisms, such as the Regulatory Sandbox.

Related questions: Q6,7,17,18,19,20,21,23,24,25,26

1.3 Customer Transparency and disclosure

The Mission CP considers the value of transparency and disclosure in addressing the information asymmetry that the FCA believes exists between firms and customers, particularly in the retail markets. While recognising the benefits of disclosure the FCA also seems increasingly strongly to believe that disclosure and transparency in retail markets can sometimes have only a very limited effect in avoiding / correcting market failures, particularly for higher risk products or for more vulnerable consumers. The Panel supports this view.

Related to this, the FCA also considers the role of behavioural economics in financial services and suggests that it can play a greater role in influencing how consumers make decisions by changing the way firms present choices to consumers ("choice architecture"), and by 'nudging'. However the FCA also says that it will consider intervening more significantly when it is clear that other measures will not work. In the interests of the transparency that the Mission CP espouses, the Panel's view is that it would be reasonable that the FCA should clearly prescribe the type of circumstances in which it would take such interventionist steps.

Both sides in a transaction need clear known responsibilities, and both sides need clear actionable sanctions if they do not fulfil their obligations. The current regulatory system does not balance those responsibilities appropriately, with unintended consequences that limit customer choice. Consumers need to be educated about their options and the consequences of their choices. They need to have the tools and information to make decisions. And they need to know what happens when they fail to honour their commitments.

Consumers also need to have access to the right information. In the Mission consultation the FCA notes that when it comes to information 'less can be more'. The Panel agrees with this statement - less information is not only important to reduce legalese in financial documents but is also important because consumers are becoming habituated into ignoring such information. Whereas in the past consumers might only be presented with these kinds of documents when making major life decisions they are now faced with them every day. At the same time as the regulations are forcing firms to provide more information, countervailing behavioural forces are pushing consumers away from reading it. A measure meant to empower consumers is in fact disempowering them.

We would welcome a definition of what the FCA considers to be 'vulnerable' customers. If work is not done at this stage, by the industry and the regulator, to define relevant vulnerable circumstances there is a danger in future that firms will be judged poorly in reference to definitions which were not clear at the time.

We are aware that the FCA has done substantial work in this area and would encourage this to be incorporated into the Mission project. This would also be related to, but not restricted to, the work on the Ageing Population (one of the Panel's key themes), taking into account the specific needs of this sector. Further work which could usefully be done in this area is to find a descriptor for 'vulnerable' customers which is less negative and which could encourage more positive interactions with these groups. An example would be to refer to customers in vulnerable or difficult circumstances, rather than vulnerable customers. This is an area where the FCA could usefully interact with firms which already have processes and terminology in place to deal with those who may be permanently or temporarily in need of extra help.

We agree, in relation to the boundary between broader policy and regulatory responsibility, that the FCA is not the appropriate body to determine whether access to financial services should be considered to be a public utility, such as electricity.

Related questions: Q4, 8.

1.4 Consumer Responsibility and Duty of Care

The Mission CP acknowledges the Financial Services Consumer Panel's view that the FCA should have a legal duty to make rules specifying what a reasonable duty of care is for financial service providers to their retail customers. However the Mission CP concludes that the FCA does not believe that a duty of care is necessary, because it believes the FCA Rules are sufficient, (although it recognises this does not provide a right of civil claim for consumers). The Panel agrees with this view, although it wishes to point out that the asset management industry is already subject to a duty of care with regards to its investors. It is difficult to see how a duty of care would apply where a provider's products are distributed by a third party regulated firm. Greater clarity on this area would be of benefit to firms.

We strongly believe that it is not appropriate to simply consider product complexity when judging appropriate levels of consumer protection, and that financial capability needs to be considered as well. We agree that the FCA should maintain its flexible regulatory approach with regards to vulnerability, as an increased potential for detriment does not only concern low income groups.

In the quest to protect we have too often stopped thinking from the perspective of what the end user needs and wants, and instead thought more often about what the rule setter can do. In the Mission consultation, the FCA notes that it does not have a specific objective to ensure consumer access or financial inclusion, but that it may “have regard” to it. The issues outside the FCA’s formally mandated control, however, cannot just be ignored. The moves that a regulator might make for protection, narrowly defined, can have an impact upon the availability and provision of services, as well as protection more broadly defined.

Protection is also about ensuring that everyone in society has access to affordable credit options. The FCA cannot be a champion of customer protection if by protecting them it removes access to the services they need and want. Heavy penalties for bad practices need to continue and there needs to be recognition that bad firms need to be allowed to fail. But over the past few years regulations have ended up preventing companies from taking on higher risk, lower income customers. Making regulations so tough that suppliers exit the market does not help consumers to take good decisions; rather, it reduces the legitimate suppliers they can choose from, and forces them into the unregulated market, making them vulnerable and reducing financial inclusion. We are aware that the FCA is already alert to this so called “waterbed effect”, where action to reduce poor industry behaviour in one area results in the same poor behaviour arising elsewhere. This must be part of the regulators’ consideration of the total impact of regulation on firms which we have highlighted elsewhere.

The difficulty of addressing consumer needs is not just the fault of legislation. It is also a fault of how the industry and the FCA look first at what they think people should do and want rather than at what they actually do and want, which ties in to the need to understand behaviours. If the FCA wishes to create the conditions for people to make better decisions it first needs to recognise that they have to make hard decisions. It also needs to recognise that the world of employment is changing, and that some of the mechanisms meant to protect consumers are excluding a whole cohort of people from credit. As the Financial Inclusion Commission found, the lived experience of ordinary people is often one without bank accounts, ID, or a good credit record. They do not always have all the pieces of paper regulations ask them to provide. They do piece work, have non-standard or zero hour contracts. One week might be fantastic, the next week terrible.

Servicing consumers in vulnerable situations, however, is risky. To decrease the cost of lending to this group, regulators have to work to decrease their risk profile, but the trend of regulation has been to make servicing such consumers more rather than less risky by reducing customer responsibility for the decisions they take. The FCA Mission is strong on consumer rights, but silent on consumer conduct. Over and above financial education consumers should also get buyers’ training about not only their rights, but also their responsibilities. If the FCA is serious about improving consumer responsibility it should start by defining responsibility.

Related questions: Q10, 11, 13, 14, 16

1.5 Enforcement

We are fully supportive of the FCA's effective use of its enforcement powers. As regulated firms should apply the same high-level standards of conduct when conducting all operations, we understand the FCA's use of its enforcement powers in a proportionate fashion in these instances.

Related questions: Q24, 25, 26

1.6 Handbook Review

The FCA note that some of the issues raised in the Mission CP may have implications for its Handbook. To support this, the FCA is planning work (through a separate Call for Evidence) to review its Handbook to identify changes that would clarify its rules. All firms should use this opportunity to provide the FCA with feedback on areas of the Handbook that have presented challenges in the past as well as arguing for a wider piece of work to simplify and streamline a handbook which is (even to the FCA) increasingly unwieldy and misunderstood. This should not be a piece of work which is rushed through but a proper holistic review to ensure there are no unintended consequences from any changes. This would entail a much longer review period in the region of years as opposed to months, particularly given the interaction with Brexit and the forthcoming Repeal Bill.

It should be a key part of the FCA's work to consider how advice can best be delivered so as to be helpful as well as definitive for consumers and with the right incentives for firms to deliver this without unreasonable fear of conduct issues.

End