

A new approach to financial regulation:
judgement, focus and stability

The Financial Services Consumer
Panel Response to CM 7874

October 2010

Index

| | |
|---|-----------|
| INTRODUCTION | 3 |
| EXECUTIVE SUMMARY | 4 |
| LESSONS LEARNT FROM THE CONSUMER PANEL’S INSIGHT | 7 |
| MAIN RESPONSE | 8 |
| CHAPTER 2 – THE BANK OF ENGLAND AND THE FINANCIAL POLICY COMMITTEE | 8 |
| CHAPTER 3 – PRUDENTIAL REGULATION AUTHORITY | 9 |
| CHAPTER 4 – CONSUMER PROTECTION AND MARKETS AUTHORITY | 10 |
| CHAPTER 5 - MARKETS AND INFRASTRUCTURE..... | 17 |
| CHAPTER 6 - CRISIS MANAGEMENT | 18 |
| ANNEX B - IMPACT ASSESSMENT | 18 |
| APPENDICES | 19 |
| APPENDIX 1 CASE STUDY – WITH-PROFITS | 19 |
| APPENDIX 2 CASE STUDY - PAYMENT PROTECTION INSURANCE (PPI)..... | 20 |
| APPENDIX 3 CASE STUDY - SPLIT CAPITAL TRUSTS | 21 |
| APPENDIX 4 CASE STUDY - PRECIPICE BONDS (STRUCTURED CAPITAL RISK PRODUCTS)..... | 22 |
| APPENDIX 5 CASE STUDY - ENDOWMENT MORTGAGES | 23 |
| APPENDIX 6 CASE STUDY – SELF CERTIFICATION MORTGAGES | 24 |
| APPENDIX 7 CASE STUDY – BANKING REGULATION..... | 25 |
| APPENDIX 8 - US FINANCIAL SERVICES REGULATORY REFORM..... | 26 |
| APPENDIX 9 - FINANCIAL REGULATION IN THE NETHERLANDS..... | 30 |
| APPENDIX 10 - THE FINANCIAL SERVICES CONSUMER PANEL | 32 |

Introduction

- 1) The Financial Services Consumer Panel welcomes the opportunity to contribute to the Treasury's consultation on the future of financial services regulation. This is a hugely important consultation which needs to deliver the right outcomes for consumers. We are intent on ensuring that the drivers outlined in HMT's new approach, namely judgement, focus and stability, are achievable and deliver a regulatory regime which serves consumers more effectively.
- 2) Given our statutory role as an adviser on consumer interest to the Financial Services Authority (FSA) we have focused our response on consumer issues. We have also taken the opportunity to gather together specific case studies¹ where the Panel has played a key role and which illustrate the points we are making. In addition, we draw useful comparisons with international work on regulatory reform in the US² and the Netherlands³ to demonstrate other approaches to consumer protection and to help ensure good practice is shared.
- 3) We have enclosed detailed comments on the proposed Consumer Protection and Markets Authority (CPMA). We have also commented on the overall approach to consumer protection and other relevant issues that are essential to ensure that the new regulatory architecture affords consumer protection the priority it deserves.
- 4) It is essential that the outcome of current deliberations on the future structure of regulation delivers a regime that serves consumers better. Given the essential role of financial services in citizens' lives, and its contribution to their wellbeing, a strong and effective CPMA needs to emerge. We believe proper resourcing, increased accountability, effective governance and improved transparency will be key. So too, will be 'joined-up' thinking and effective interaction and communication between the new regulatory bodies to avoid potential and actual overlaps or 'underlaps' in supervision.
- 5) We are keen to participate actively in the current debate on the future of regulation to ensure consumer protection is enhanced and that consumers can rely on a regime which has their needs at its heart. Ultimately, it is consumers who bear the cost of regulation. It is therefore, essential to ensure the future regime serves them well and learns from the successes and weaknesses of the past.

¹ See [Appendices](#)

² [Appendix 8 US regulatory reform](#)

³ [Appendix 9 financial regulation in the Netherlands](#)

Executive Summary

Judgement, focus and clarity

- 6) The failings of the regulatory system have been well documented. The weaknesses have been associated with the 'light touch' regulatory approach that characterised the FSA from its inception and throughout much of the financial crisis. More recently, there have been welcome steps by the FSA towards a more vigorous stance on consumer protection, with earlier, more robust enforcement and intensive supervision. We believe this focus needs to continue. To be beneficial to consumers, the new Consumer Protection and Markets Authority needs a clearer remit and stronger powers than the FSA. It also requires the will and confidence to exercise judgement and actively to use the powers at its disposal to protect consumers, who are not homogenous and whose diverse interests need to be understood fully.

We believe an effective regulator should:

- *Have strong and experienced leadership*
- *Have sufficient, high-quality consumer input at Board level*
- *Be evidence based*
- *Have and deploy actively a range of strong regulatory tools*
- *Be fearless in the face of an industry that has long been favoured by government and which has recourse to expensive legal and lobbying activity*
- *Have timely and effective enforcement and redress mechanisms at its disposal*
- *Be transparent and accountable*

We are calling for a regulator to deliver intelligent regulation, ensuring firms abide by the rules, and to uphold consumer interest with effective redress and timely and appropriate compensation for consumers.

Consumer champion

- A mandate to act as a strong consumer champion - the CPMA needs clarity of purpose and focus to act in the consumer interest, with the delivery of clearly articulated, good consumer outcomes central to its operating philosophy.

Its primary objectives should be:

- a) to protect and uphold the interests of existing and future consumers in relation to the provision of financial services to ensure that all persons have access to financial services which are fair, transparent and competitive, and;*
- b) to ensure the integrity of markets so that all persons have access to markets for financial services which are fair, transparent, efficient, stable and competitive.*

It should also have a secondary objective:

to carry out its functions in the manner it considers is best calculated to further the principal objectives, wherever appropriate, by promoting effective competition between persons engaged in authorised activities.

- If competitive markets do not deliver efficient and fair outcomes for consumers, the CPMA, like many other industry regulators, needs to be able to act on excessive prices and charges to remedy detriments.
- These objectives also require strong leadership backed up by greater powers to crack down quickly and effectively on dubious practices, challenge business models and if necessary to ban products. The focus of the new CPMA should be on early effective intervention rather than the FSA's past concentration on the efficacy of sales processes. The CPMA should continue and extend the FSA's recently developed analysis of and challenge to business models, and should retain, and use actively, the FSA's powers.
- Given the social role played by financial services in our various communities, regard must also be paid to the public interest including the broader interests of citizens including the disadvantaged.
- The efficiency and competitiveness of wholesale markets are critical as this is where people's savings and pension funds are invested. The proportionality of costs is important as higher transaction costs in these markets mean higher charges for consumers which have an adverse impact, especially when compounded over a lifetime of savings. The CPMA needs the power to intervene to drive down these transaction costs. The Consumer Panel remains concerned that the CPMA may lack sufficient tools to do this, hence our call for the CPMA to have an effective toolkit that will enable it to act appropriately as an economic regulator.

Remedy and Redress

- Straightforward, fast access to remedy and redress are essential with greater clarity for consumers as to how they enforce their rights;
- Per-brand authorisation of banks so that consumers can easily understand who they are contracting with and the level of protection they are entitled to in the event of problems.
- Effective enforcement with fines in the same league as competition regulators so that financial services organisations fear the intervention of the regulator, and stronger powers, where necessary, to ban products and senior executives from the industry and effectively incentivise good behaviour in others;

Transparency

Transparency has many different facets and is of particular relevance both in determining the role of the CPMA and the behaviour of the industry.

- A presumption in favour of transparency would reduce the need for time consuming and expensive enforcement action.
- The CPMA should have a duty to publish as much meaningful information as possible on the performance of regulated firms so that transparency becomes a regulatory tool empowering consumers to take well-informed decisions, choose well-run businesses to do business with. It will also create a market pressure in favour of compliance and better industry behaviour;

- Transparency should also be key to the CPMA's operation, with timely publication of board minutes etc. As a regulator, the new CPMA should lead the field in terms of best practice regarding transparency, naming, faming and shaming relevant firms and giving examples of best and worst practice.

Consumer Credit and Claims Management

- Incorporation of consumer credit powers into those of the CPMA would end the fundamental divide in financial services protection. The Panel believes that extending the CPMA's role to regulating credit for CPMA authorised financial services firms would give greater clarity in the regulation of consumer financial products;
- Likewise, the Panel would like to see an extension of the CPMA's remit to the financial services aspects of claims management companies and debt management and advice firms.

Governance and accountability

- Leadership and governance will be key. We believe the majority of the Board of the CPMA should be people with experience of consumer regulation and insight into consumer interest. The mistake of the early FSA board of having too strong an industry bias must not be repeated;
- Effective accountability and reporting lines are critical, as is access to the Chancellor and the Secretary of State for Business. In addition, regular review by the Treasury Committee would increase oversight and Parliamentary accountability;
- We believe accountability to the Panels should be increased. The Panels already engage at an early stage in the formulation of FSA regulation, and enhanced requirements for early consultation and increased accountability, written into the forthcoming legislation to strengthen governance in the new structure;
- The Panel strongly believes that there must be appropriate information sharing between CPMA and PRA supervisors to ensure that there is a joined-up approach to regulation.
- There must also be appropriate consumer representation at a senior level throughout the new regulatory structures.

Lessons learnt from the Consumer Panel's insight

- 7) Given our unique position as a statutory adviser to the FSA, the Consumer Panel has an unparalleled insight into the past performance of the FSA in protecting consumers. While there have been considerable strengths, and we have been impressed by the FSA's progress in recent years, there have historically been very serious weaknesses. We have compiled a study of relevant cases where the Panel has been involved and which highlight the points we are making and add weight to our call for effective change.
- In the first four case studies with-profits⁴, payment protection insurance⁵, split capital trusts⁶ and precipice bonds⁷ the FSA took too little action, too late. With endowment mortgages⁸ and self-certified mortgages⁹ there was a lack of adequate regulation as well as a lack of action. Banking regulation¹⁰ demonstrates what can happen when regulation is insufficiently joined-up;
 - FSA investigations were not completed fast enough with successive ineffectual investigations resulting in escalating consumer detriment and an overburdened Financial Ombudsman Service picking up the pieces. This weak approach has been made manifest by the emergence of major mis-selling scandals;
 - A lack of transparency by the FSA arising from constraints in the original Financial Services and Markets Act 2000 and a consequential inability to disclose information has left consumers in the dark, oblivious to the unacceptable treatment experienced by others;
 - Enforcement has historically been insufficiently robust or frequent, particularly against large firms which were therefore under little pressure to improve compliance. The modest fines set proved no deterrent to existing behaviours or harmful practices;
 - Because the FSA has not had a duty to promote effective competition amongst providers that delivers good consumer outcomes, it has not therefore pursued this approach to improving outcomes for consumers. Because of light-touch regulation and the FSA's approach to undertaking its duties, the FSA has carried out little economic and market analysis that would illuminate the underlying sources of consumer detriment;
 - The FSA's concentration on sales processes rather than business models and product development detracted from an effective focus on earlier intervention;
 - The wider implications, risks and lessons from past business reviews were not picked up in many cases and consequently industry behaviour did not improve.

⁴ See Appendix 1

⁵ See Appendix 2

⁶ See Appendix 3

⁷ See Appendix 4

⁸ See Appendix 5

⁹ See Appendix 6

¹⁰ See Appendix 7

MAIN RESPONSE

Chapter 2 – The Bank of England and the Financial Policy Committee

1 Should the FPC have a single, clear, unconstrained objective relating to financial stability and its macro-prudential role, or should its objective be supplemented with secondary factors?

- 8) The FPC needs to have a clear primary objective relating to financial stability, but as is the case with other regulators, this has to be supplemented with secondary considerations and, in particular, the objectives of the CPMA and PRA. All the new bodies should 'have-regard to each others' objectives in carrying out their work.

2 If you support the idea of secondary factors, what types of factors should be applied to the FPC?

- 9) In terms of the secondary factors the FPC should also have regard to the broader public interest, for example in reflecting on the needs of citizens in vital aspects such as future pensions and effective retirement provision, home ownership and the availability of consumer credit.

- 10) The Panel has two particular concerns, firstly that the balance of power in the regulatory mix should not be tilted too far away from consumers in favour of macro prudential regulation and secondly, that the new bodies must work effectively and constructively together.

- 11) However, not only must the new bodies work together effectively, they must also have appropriate relationships with the Consumer Financial Education Body (CFEB), the Financial Services Compensation Scheme (FSCS) and the Financial Ombudsman Services (FOS), to ensure that information and best practice are shared. Consideration therefore needs to be given to appropriate use of memoranda of understanding between the new bodies to facilitate good communication and the sharing of information, as in the Dutch system¹¹. Lessons can also be learnt from the statutory duty the Netherlands bodies have to minimise unnecessary costs.

- 12) It is also important that the external members of the FPC have a sufficiently broad grasp of consumer issues and the consumer perspective so that this body does not have an overly strong industry perspective.

3 How should these factors be formulated in legislation – for example, as a list of 'have regards' as is currently the case in the Financial Services and Markets Act 2000 (FSMA), or as a set of secondary statutory objectives which the FPC must balance?

- 13) The additional factors should be formulated in legislation as 'have regards'.

- 14) The example of sub prime mortgages and the FSA's ongoing mortgage market review is of relevance here in that concerns are already emerging about the possibility of consumer detriment from a poorly co-ordinated approach to asset bubble management.

¹¹ See [Appendix 9](#)

It would be very concerning if under the new structure, it were possible for high level decisions to be taken for reasons of macro prudential stability, which had an unnecessarily negative impact on citizens because of a lack of involvement at an early stage in the process from bodies tasked with protecting their interests.

Chapter 3 – Prudential Regulation Authority

4. The Government welcomes respondents' views on:

- *whether the PRA should have regard to the primary objectives of the CPMA and FPC;*
- 15) Each of the new bodies should pay due regard to each others' primary objectives, at least in their 'have regards'.
- 16) The Consumer Panel believe that the PRA must not be treated as senior to the CPMA. This would mean that consumer protection and market stability are not both accorded the importance they deserve.
- *whether some or all of the principles for good regulation currently set out in section 2 of FSMA, particularly those relating to good regulatory practice, should be retained for the PRA;*
- 17) We agree in general that the principles from section 2 of FSMA should be retained for the PRA and that with regard to competition, this should be related to promoting effective competition i.e. providing clear consumer benefit in terms of value.
- *whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained;*
- 18) We do not think it is the PRA's role to consider the impact on the global competitiveness of UK financial services.
- *and whether there are any additional broader public interest considerations to which the PRA should have regard.*
- 19) As with our view on the FPC there are broader public interest considerations to which the PRA should have regard. These include reflecting on the needs of citizens with regard to future pensions, home ownership and the availability of consumer credit

5 Is the model proposed in paragraph 3.16 – with each authority responsible for all decisions within their remit subject to financial stability considerations – appropriate, or would an integrated model (for example, giving one authority responsibility for authorisation and removal of permissions) be preferable?

6 Is the approach outlined in paragraph 3.17 to 3.23 for transfer of regulatory functions and rule making sufficient to enable the PRA to take a more risk-based, judgement-focussed approach to supervision?

20) We have nothing to add at this stage on Questions 5&6

7 Are safeguards on the PRA's rule-making function required?

8 If safeguards are required, how should the current FSMA safeguards be streamlined?

21) In so far as it is possible, the PRA should retain the present rule making processes of the FSA. These have been tried and tested and have evolved into a balanced approached to regulation based on principles and rules.

9 The Government welcomes views on the measures proposed in paragraphs 3.28 to 3.41, which are designed to ensure that the operation of the PRA is transparent, operationally independent and accountable.

22) We welcome the proposed accountability mechanisms for the PRA, and the reference to the accountability mechanisms present in the FSA (described in 4.36 of the consultation document) which includes a reference to consultative panels. The PRA should consult with the Independent Panels, in particular the Consumer Panel, when undertaking aspects of its work which will impact on consumers.

Chapter 4 – Consumer Protection and Markets Authority

10 The Government welcomes respondents' views on:

- *whether the CPMA should have regard to the stability of firms and the financial system as a whole, by reference to the primary objectives of the PRA and FPC;*

23) Financial stability is clearly an overarching requirement which underpins consumer protection. Yet, given the proposed new regulatory landscape and the focus of the FPC, we believe the CPMA should have a primary objective of: **protecting and promoting the interests of existing and future consumers in relation to the provision of financial services**. At an operational level, misbehaving firms should not be able to escape censure by arguing that the fine or redress might impact on firm stability.

- *whether some or all of the principles for good regulation currently set out in section 2 of FSMA should be retained for the CPMA, and if so, which;*

24) The CPMA objectives should be as follows:

Primary objective:

- a) to protect and uphold the interests of existing and future consumers in relation to the provision of financial services to ensure that all persons have access to financial services which are fair, transparent and competitive, and;
- b) to ensure the integrity of markets such that all persons have access to markets for financial services which are fair, transparent, efficient, stable and competitive.

The CPMA should have the following **secondary objective:**

to carry out its functions in the manner it considers is best calculated to further the principal objectives, wherever appropriate by promoting effective competition between persons engaged in authorised activities.

The CPMA should have the following **'have regards'** considerations to be taken into account in pursuit of the principal objectives:

- a) the objectives of the FPC and PRA;
- b) the need to ensure that authorised firms are able to finance the activities which are the subject of obligations on them;

- c) the need for consumers in all parts of the United Kingdom to be treated fairly by the firms with which they deal and to secure value for money;
- d) the need for consumers to be provided with as much information as possible concerning the performance of authorised firms;
- e) the desirability of promoting public understanding of the financial system;
- f) the desirability of promoting financial inclusion
- g) the desirability of promoting diversity and encouraging new providers of financial services;
- h) the need to use resources in the most efficient and economic way;
- i) the principle that a burden or restriction which is imposed on a person should be proportionate to the benefits which are expected to result from the imposition of that burden;
- j) the need to minimise the adverse effects on competition that may arise from anything done in the discharge of its function.

25) We have looked at examples from other jurisdictions and other sectors in balancing the range of objectives and 'have regards' we consider appropriate for the CPMA and how best to make use of competition. Both the US Bureau of Consumer Financial Protection¹² and the Dutch authority the AFM¹³ are good precedents in our view for the kind of remit the CPMA needs.

26) In terms of examples from other regulated industries, OFCOM and OFGEM in carrying out their functions have a primary duty to promote the interests of citizens and to further the interests of consumers, *where appropriate, by promoting competition*. In the case of OFGEM it is quite clear that the regulator is to carry out its functions in a way it considers best calculated to further its principle objective and this may or may not be through promoting competition.

27) While examples from sectors concerned with commodities cannot be directly compared with financial services, we think there are lessons which can be learnt due to the increasing commoditisation of some financial services. A characteristic of these other regulated industries is a combination of universal coverage and competitive supply. However, financial services and utilities are not entirely analogous and consequently, we believe it sufficient to refer to competition as a secondary, rather than a primary objective for the CPMA.

28) The CPMA should also be required to have regard to the fair treatment of consumers and for citizens to be able to secure value for money through having access to as much information as possible on the performance of regulated firms. This is the position in other regulated sectors and it is a good position for the new CPMA.

- *whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained; and*

¹² [Appendix 8](#)

¹³ [Appendix 9](#)

- 29) We agree that the requirement to have regard to impacts on global competitiveness of the UK financial services sector should not be retained.
- 30) Consumers are also concerned about the efficiency and competitiveness of wholesale markets as this is where their savings and pension funds are invested. The proportionality of costs is important as higher transaction costs in these markets mean higher charges for consumers which have an adverse impact on savings, especially when compounded over a lifetime. The CPMA needs the power to intervene to drive down these transaction costs.
- 31) The Consumer Panel remains concerned that the CPMA may lack sufficient tools to carry out its role, hence our call for the CPMA to have an effective toolkit that will enable it to act as an economic regulator if appropriate.
- *whether there are any additional broader public interest considerations to which the CPMA should have regard.*

CPMA as Consumer Champion

- 32) As a Consumer Champion there are a number of broader public interest considerations and regulatory practices which the CPMA will need to take into account in its work.
- 33) It is important that the CPMA takes account of the public interest in terms of furthering the interests of citizens and consumers in promoting an economically and socially sustainable market in products and services. We have previously referred to reflecting the needs of citizens with regard to future pensions, home ownership and the availability of consumer credit. Increasingly, financial services are becoming essential to everyday life and it is crucial that all consumers including the vulnerable and disadvantaged are protected.
- 34) Protecting and promoting the interests of all consumers will only result from intelligent regulation of the financial services market which fully takes into account the complexity and diversity of the market. We define intelligent regulation as a system whereby regulators make balanced, proportionate judgements on firms' business models based on prudential and conduct information, rules and principles. This can be differentiated from more primitive forms of box-ticking regulation, in that supervisors use their judgement and experience based on a holistic view of the entirety of the information available. Naturally, this calls for high calibre supervisors able to hold their own when dealing with financial services companies. Intelligent regulation should result in clear, joined-up, enforceable rules which offer one-stop regulation, proactive market and firm monitoring for early risk identification and effective product scrutiny. Consequently, the Panel is concerned that splitting prudential and conduct supervision between the CPMA and PRA introduces a new risk in that regulators may no longer have the perspective of the entire regulatory landscape resulting in disjointed regulation. The risks of disjointed regulation can be seen in current banking regulation in relation to the respective roles of the FSA and OFT¹⁴.
- 35) Making firms adhere to the rules involves using credible deterrence so that firms fear the reputational and financial risk of non-compliance. This will require the CPMA to have the correct leadership, so that it can take strong action, to have clarity in terms of its remit and to be able to employ greater transparency as an effective tool in the regulatory process. There also needs to be confident, high quality enforcement staff equipped with the powers to act effectively and quickly to ensure swift compliance.

¹⁴ See Appendix 7

With-profits, PPI, precipice bonds and split caps all illustrate what can happen when a regulator does not act decisively and quickly.

- 36) Additionally, intelligent regulation encompasses the concept of making early challenges to business models when required and increasing product scrutiny to ensure toxic products do not get copied across the market, introducing widespread detriment which is ultimately expensive for both consumers and the industry. We strongly support powers that enhance earlier, effective market and product interventions, subject to the principles of proportionality and effectiveness. Endowment and self-certified mortgage mis-selling are examples of the type of problem caused by weak regulation which should not be allowed to recur.
- 37) It is also important that in undertaking its work as a consumer champion the CPMA takes account of consumers in the nations and regions of the UK. The previous FSA regime came into effect before devolution and with a separate legal jurisdiction and Parliament in Scotland as well as an Assembly in Wales the CPMA needs to take account of the increased diversity of the UK and the different public interest considerations which may apply in different areas.

Transparency

- 38) Greater transparency will allow consumers access to better information on which to make informed choices about financial products and services and the companies with which they do business. This would involve the CPMA in faming, naming and shaming; giving examples of best and worst practice.
- 39) Fewer consumers would have suffered detriment if there had been more and earlier “naming and shaming” of PPI¹⁵ mis-sellers.
- 40) The CPMA should go out of its way to render this information into a form which will be easily understood by consumers, thus giving consumers the power to make informed choices and if necessary take their business elsewhere. We would also like to see clear powers to publish complaints data and the publication of Own Initiative Variation of Permissions (OIVOPs).
- 41) The Consumer Panel has undertaken considerable research into transparency over the last few years and in our more recent report *Transparency as a Regulatory Tool*¹⁶ we have found that the FSA, although comparing well to other international comparisons, could go further. We would like to see the CPMA become a global leader in transparent reporting of firm complaints, enforcement proceedings, financial promotions and corporate Governance issues. There should be a presumption in favour of transparency to allow consumers to make sensible choices and responsible businesses to prosper.
- 42) To allow for greater transparency, the Panel has argued for changes to sections 349 and 391 of FSMA 2000. Section 349 should be amended to allow information which the FSA finds in the course of its work, such as complaints data, to be disclosed in pursuit of its consumer protection objective with the usual safeguards of proportionality and cost effectiveness. Our section 391 amendment would allow the publication of warning notices, the FSA’s equivalent of a formal charge, in line with standard practice in law

¹⁵ See [Appendix 2](#)

¹⁶ *Transparency as a Regulatory Tool*, John Leston

enforcement. Enforcement action can take years to complete, during which time consumers can continue to suffer major detriment oblivious to the serious allegations which are being investigated. Consumers should therefore have the right to know at the earliest opportunity that a firm or an individual is under investigation so that they can take action to protect themselves

43) This view on transparency was endorsed by the Conservative White Paper¹⁷

“we will force banks to be more transparent about their retail consumer charges. Effective competition relies on consumers being able to make informed choices. Increasing transparency on charges will help consumer compare products. This approach is also being pursued by the Obama administration in the US.”

44) A logical adjunct to this is that consumers need to easily understand the level of protection they are entitled to in terms of deposit guarantees. One important improvement would be to introduce per-brand authorisation of banks. This would remove the uncertainty about the compensation available which results from the myriad brands owned by some institutions. Consumers would be under no illusions as to precisely the level of protection they have for their money in a bank. During the 2007/08 Financial Crisis the Consumer Panel lobbied for increased compensation as it was clear some consumers had underestimated the level of protection they possessed because of brand confusion.

Effective Redress and ensuring compliance

45) Effective redress can only be accomplished if firms understand their regulatory obligations to handle complaints fairly. They must learn that it will be cheaper for firms and consumers to resolve problems earlier. Likewise, timely and appropriate compensation will only occur if the regulator is both empowered and motivated to get tough with firms. This requires strong leadership and a remit to protect consumers along with effective enforcement.

46) The CPMA must compel the industry to take stronger action towards treating customers fairly. The CPMA should enforce this through analysis of business models and regulation where competition is ineffective. It should include effective powers for the CPMA to ban products and expel senior executives from the industry if appropriate.

47) The Panel is concerned about the possible creation of the new Economic and Financial Crime Agency and the risks this may pose for effective enforcement in the financial services industry. It is vital for the success of the CPMA that it has adequate enforcement powers. The new EFCA agency would fragment enforcement creating an inefficient two tier enforcement structure, with lower-level activity dealt with at the CPMA.

48) Related to this is our concern about the interaction between supervisory teams and the possibility that if PRA supervisors lead teams from both the PRA and CPMA information relevant to the CPMA may not be passed on and that information may flow only in one direction towards the PRA. Unless there is an adequate dual or reciprocal flow of information the CPMA will be left ill-informed about consumer protection and market stability issues. In the US this is accomplished by the requirement of prudential regulators to share their reports and examinations with the Bureau of Consumer Financial Protection¹⁸. Aligned audit processes in the CPMA and PRA are essential to

¹⁷ From Crisis to Confidence: Plan for Sound Banking, Policy White Paper July 2009

¹⁸ See [Appendix 8](#)

police the delivery of efficient and effective supervision. The Dutch regulator¹⁹ the AFM has a co-operation covenant with the central bank the DNB. We think that the UK equivalent – the memorandum of understanding - should be used to ensure that the PRA and CPMA teams work closely together and that they work to minimise the impact on firms both in terms of regulatory burden and cost.

- 49) We also envisage that the CPMA will need an effective working relationship with CFEB given the shared subject matter of their work. Moreover, we think that better information-sharing between FOS and the CPMA will assist the CPMA in its consumer protection function as it will be able to identify issues more easily when they first arise.

Joined-up regulation of consumer credit and financial claims management

- 50) The CPMA should take on the consumer credit powers of the OFT in relation to firms authorised by the CMA. This would give greater clarity in the regulation of consumer financial products. The experience of the FSA in banking regulation²⁰ is a cogent example of the sort of problems faced by consumers because of disjointed regulation.
- 51) We also take the view that the CPMA should take on the regulation of claims management companies where they are involved in financial services and that this should apply throughout the United Kingdom. There is also a case for regulating debt management companies.
- 52) Extension of the CPMA's powers into these two areas would give the new body a comprehensive overview of the consumer landscape and end the somewhat arbitrary and illogical division between FSA, OFT and MoJ responsibility which currently exists.

Consumer representation on the CPMA board

- 53) The CPMA must have sufficient consumer experience at board level. One of the early mistakes of previous regulatory reform was that the FSA board was too close to the industry which it regulated. The CPMA needs to hit the ground running with a high-calibre board which is not afraid to stand up to industry and act fearlessly in the interests of consumers.

11 Are the accountability mechanisms proposed for the CPMA appropriate and sufficient for its role as an independent conduct regulator?

- 54) In answer to Question 11, to ensure that the CPMA is effective in meeting its objectives and that consumer financial issues are sufficiently represented at Cabinet level, the CPMA should have direct access to the Chancellor of the Exchequer and report on consumer issues in the same way as the PRA reports on prudential matters. Moreover, we want to establish the principle that the CPMA, also has a similar reporting relationship with the Secretary of State for Business and the Treasury Committee of the House of Commons.
- 55) Given the departure of Hector Sants to the PRA and his appointment as a Deputy Governor of the Bank it is essential for the success of the CPMA that an energetic and high calibre CEO is appointed at the earliest opportunity. The CPMA will only succeed if it has a powerful and competent Chief Executive who can manage the transition.

¹⁹ See [Appendix 9](#)

²⁰ See [Appendix 7](#)

12 The Government welcomes views on the role and membership of the three proposed statutory panels for the CPMA.

The Role of the Panels

- 56) We support the proposal to make the Smaller Businesses Practitioner Panel into a third statutory Panel. It is important that the CPMA continues to enjoy the input provided by the Consumer Panel, Practitioner Panel and Smaller Businesses Practitioner Panel.
- 57) Over the last decade the Panels have provided an increasingly useful service in assisting the FSA to formulate policy by providing cogent challenging advice. As is presently the case,²¹ the CPMA should be under the same duty as the FSA to consider the representations of the Panels and provide statements²² of reasons if it disagrees.
- 58) The Consumer Panel has endeavoured to deliver effective advice on behalf of consumers and we have detailed some of the work of the Consumer Panel over the last decade in the case studies supplied²³.
- 59) We believe the role of the Panels should be enhanced in the new regime to improve the CPMA's governance. In particular, we would like to see increased and effective Panel resourcing and a stronger obligation on the CPMA through statute to consult and take note of the Panel's recommendations and challenges.
- 60) Moreover, the three Panels representing consumer and practitioner interests should not only provide input to the CPMA. We believe the Panels have become an effective part of the FSA's governance structure and should be enabled to advise the FPC and PRA, to ensure that consumer and practitioner interests are adequately represented. When applicable, the FPC and PRA should have a duty to liaise with and consult the Independent Panels to ensure that there is proper scrutiny of decisions.
- 61) Specifically in the case of the Consumer Panel, we recommend that it has a formal duty to report to the Treasury Select Committee on a regular timetable.

13 The Government welcomes views on the proposed funding arrangements, in particular, the proposal that the CPMA will be the fee- and levy-collecting body for all regulatory authorities and associated bodies.

- 62) Question 13 raises some important issues regarding the funding arrangements for the new bodies. We agree that it is sensible to share support infrastructure as indirectly all costs will inevitably be borne by consumers. Consequently the Panel is very concerned that the new structure will lead to a duplication of staff and structures. In as far as it is possible, new bodies should share resources in the form of data, supervision staff, IT systems and Independent Panels. This is a problem which has been addressed in the Dutch system²⁴ by a "covenant" between the conduct and prudential regulators and also by a statutory duty to minimise unnecessary costs. A similar memorandum of understanding will be needed between the FPC, PRA and CPMA
- 63) The Consumer Panel is concerned that there is insufficient clarity as to how the bodies which are also funded by the levy, such as Financial Ombudsman Service (FOS), Financial Services Compensation Scheme (FSCS) and the Consumer Financial

²¹ s11(2) FSMA 2000

²² S11(3) FSMA 2000

²³ See [Appendices](#)

²⁴ See [Appendix 9](#)

Education Body (CFEB), are resourced. We are concerned that the proposals as they stand give insufficient certainty to the issue of funding and consequently risk the independence and sustainability bodies dependent on the industry levy.

14 The Government welcomes views on the proposed alternative options for operating models for the FSCS.

64) The Consumer Panel does not have a response to Question 14.

Chapter 5 - Markets and Infrastructure

15 The Government welcomes views on the proposed division of responsibilities for markets and infrastructure regulation.

65) As discussed with regard to the CPMA, consumers are also concerned about the efficiency and competitiveness of wholesale markets as this is where savings and pension funds are invested and transacted. Inefficiency and a lack of competitiveness result in higher transaction costs which are borne by consumers in the form of higher charges. Charges which are higher than they need be will, over the long lifetime of many financial products, have a large impact.

66) The CPMA needs the power to intervene to drive down these transaction costs. The Consumer Panel remains concerned that the CPMA may lack sufficient tools to do this, thus our call for the CPMA to have an effective toolkit that will enable it to act as an economic regulator if appropriate.

16 The Government welcomes views on the possible rationalisation of the FSMA regimes for regulating exchanges, trading platforms and clearing houses

67) The Consumer Panel is concerned that the rigour currently instilled in the UK system by the FSA is not lost in any rationalisation.

17 The Government would welcome views on whether the UKLA should be merged with the FRC, as a first step towards creating a companies regulator under BIS.

18 The Government would also welcome views on whether there are other aspects of financial market regulation which could be made more effective by being moved into the proposed new companies regulator.

68) In response to Questions 17 and 18, the Consumer Panel is concerned about the proposed changes as the present system has worked well without the sort of failures seen in other areas of the financial or regulatory system. The proposed changes could increase regulatory complexity and do not appear to offer any significant advantage over the present arrangements.

69) There are natural synergies between the markets work of the CPMA and the work of the UKLA and a separation could weaken market regulation. We also note that the current European structure under the ESMA would be a poor fit with the proposed new UK arrangements and that this could potentially weaken the UK's voice in the European Union.

Chapter 6 - Crisis Management

19 Do you have any overall comments on the arrangements for crisis management?

70) The Consumer Panel is concerned that the CPMA is not sufficiently included in the crisis management structure. As in other areas of reform, we have called for greater regard to be given to the public interest. There is a need to take into account the broader interests of consumers with regard to the management of future crises.

71) It is important to bear in mind that during the Northern Rock crisis it was the televised scenes of customers queuing around the block that did much of the damage to the reputation of the banking system and the UK as a whole. The body charged with being the consumer champion needs to be involved throughout to ensure that the concerns and interests of consumers are adequately taken into account.

20 What further powers of heightened supervision should be made available to the PRA and the CPMA, and in particular would there be advantages to mandatory intervention, as described in paragraph 6.17?

72) The Consumer Panel supports the enhancement of OIVoP powers as part of a more proactive and consumer focussed regulatory process.

21 What are your views about changes that may be required to enhance accountability within the SRR, as described in paragraphs 6.21 to 6.24?

73) The Consumer Panel has nothing to add on Question 21.

Annex B - Impact Assessment

22 Annex B contains a preliminary impact assessment for the Government's proposals. As set out in that document, the Government welcomes comments from respondents on the assumptions made about transitional and ongoing costs for all types of firm. In particular, comments are sought from all types and size of deposit-taking, insurance and investment banking firms (including credit unions and friendly societies), and from groups containing such firms.

74) The Consumer Panel has no comment on Question 22.

Appendices

Appendix 1 Case Study – With-profits

The FSA acted too slowly. Consumer Panel research highlighted significant problems in the governance arrangements of with profits funds.

With-profits funds are pooled investment funds that are run by insurance companies or mutual societies. They invest in equities, bonds, gilts and property. They were formerly seen as safe investments and the funds have around 20 million investors. In recent years many of these funds were hit by stock market falls and returns were significantly reduced.

Concerns grew about the effectiveness of so-called “smoothing” mechanisms supposed to keep up bonuses in the bad years; and a lack of transparency surrounding market value adjustments designed to protect existing policyholders when investments leave the fund early.

FSA Action

The FSA has had concerns about with-profits funds for many years and has looked into them on several occasions. In the early 2000s the FSA did a good job in resolving some of the problems in the with-profits sector. In 2005 the FSA introduced rules for with-profits funds to ensure that the investors were treated fairly.

However, in June 2010 FSA With-Profits Report²⁵ showed that with-profits policyholders are still not being treated fairly by the FSA on its own measures despite previous warnings to the industry by the FSA.

Regulatory Shortfall

The Consumer Panel has conducted reviews and research into the With Profits Sector and held a round table on with profits funds in 2010.

Previously, in 2007 Consumer Panel research²⁶ showed a lack of advice available from financial advisors and poor information provided by companies to consumers. The Panel was also concerned about the inconsistent treatment of different investor groups.

In 2008²⁷ further research gave rise to a concern about inherited estates, with-profits committees, the permitted uses of funds and governance of funds.

The FSA has acted too slowly in working to resolve the range of problems with the funds and to provide adequate redress²⁸.

²⁵ http://www.fsa.gov.uk/pubs/other/withprofits_report.pdf

²⁶ 2007/2008 Consumer Panel Annual Report p30

²⁷ 2008/09 Consumer Panel Annual Report pp 6,12

²⁸ 2009/10 Consumer Panel Annual Report p20

Appendix 2 Case Study - Payment Protection Insurance (PPI)

The FSA took too long to act. However, consistent campaigning by the Consumer Panel pressured the FSA to take stronger action on PPI.

Payment Protection Insurance (PPI) policies are designed to cover all or part of the payments on loans, mortgages and other financial products if the policy-holder was unable to work. In some cases the cost of the policy is added to the loan, substantially increasing the overall cost. In many cases the policies have not provided the protection that was claimed and some consumers were not eligible to make claims in certain circumstances – in other words, there has been large-scale mis-selling.

FSA Action

The FSA started to act against PPI mis-selling in 2005. In 2007 its own research showed that some firms were still failing to treat their customers fairly. In 2008 the FSA banned single premium PPI policies with unsecured loans as this was the most damaging area of PPI sales. The FSA also took regulatory action by censuring 10 firms and giving the largest ever retail fine for PPI mis-selling. However, the FOS was still receiving a very large number of complaints about PPI policies and it pointed out to the FSA that there appeared to be a wider regulatory failure in this area - despite high rejection rates of complaints by firms, over 80% referred to the Ombudsman were overturned in favour of consumers.

In 2009 the FSA issued proposals for more rigorous investigation of PPI complaints, but there was strong opposition from industry and this delayed progress.

In 2010 the FSA issued a deadline of 1 December 2010 for firms to comply with the new policy statement published in August 2010. The FSA is now the subject of a judicial review, so it seems there will be further delay in implementing the FSA's new requirements.

Regulatory Shortfall

The Panel has been concerned about PPI since 2007²⁹ and has repeatedly stated that the FSA has been slow to respond³⁰.

The Panel asked the FSA to carry out more enforcement action and to require firms to carry out past business reviews. The Panel supported the FSA's proposals for changes but has been disappointed with the slow progress. The Panel has also asked the FSA to tackle PPI sold with credit cards, secured loans and mortgages since these may also have been mis-sold.

The FSA has been ineffective and taken too long to address problems with PPI in spite of receiving many warnings from different sources.

²⁹ 2007/08 Consumer Panel Annual Report p31

³⁰ Repeated 2008/09 Consumer Panel Annual Report pp 6, 11 and 2009/10 pp 25, 26

Appendix 3 Case Study - Split Capital trusts

The FSA lacked the powers to adequately resolve the problems and was consequently slow to act.

Split Capital Trusts operate by investing client money in shares for a fixed period (normally five to ten years). There are two types of shares – income shares (that pay dividends) and capital shares (that generate capital growth only) and investors can choose between income and capital growth.

The shares were wrongly sold as being very low risk investments. Problems arose when the firms operating the funds expanded too rapidly. They also invested in each other's investment trusts, resulting in a web of cross-ownership. When the stock market fell, high-gearing and cross-holdings between trusts caused some investments to fall sharply in value and some investors lost all their capital.

FSA Action

The FSA launched a large investigation into split caps in May 2002 which resulted in firms agreeing to pay into a £144 million compensation fund on Christmas Eve 2004. Agreement was reached without admissions by two further firms in April 2005.

There was widespread discontent with this result as by some estimations investors had lost £700 million and the FSA was criticised for lack of action even though it had known about the problems earlier. The FSA had however been hampered by the fact that investment trusts were not regulated products and that the period under investigation straddled the introduction of the FSA.

Regulatory Shortfall

The Panel called on the FSA to publish more information to help consumers^{31 and 32}. In particular, regarding eligibility to complain and the names of 'problem' trusts³³.

The FSA was accused of complacency by the Treasury Select Committee and others and consumers suffered financial loss. The Panel demanded that the FSA name and shame problem trusts but the view of the FSA at the time was that these trusts were outside its remit.

³¹ Consumer Panel 2001/02 Annual Report p59

³² Consumer Panel 2002/03 Annual Report p7

³³ Consumer Panel 2002/03 Annual Report p30

Appendix 4 Case Study - Precipice Bonds (structured capital risk products)

The FSA took too little action, too late. The Consumer Panel consistently warned of the detriment consumers were suffering and demanded firmer, faster action.

Precipice bonds are high risk investment products. They pay a regular income over a period of up to five years but the capital may dwindle to nothing over the term of the investment. Many investors were pensioners who were persuaded to invest by advertisements promising double-digit returns but not mentioning the risks involved. It has been estimated that £7.4 billion was invested between 1997 and 2004, most of which was lost.

FSA Action

The FSA fined firms that mis-sold precipice bonds and increased its scrutiny staff from 4 to 25. Warnings were issued to consumers from December 1999 and thereafter with a series of consumer fact-sheets. Fines were imposed against a number of firms including £300,000 for Capita Trust Company Ltd (formerly Royal Sun Alliance)

Regulatory Shortfall

Members of the Treasury Select Committee raised concerns about the FSA's inaction and implicit approval of some precipice bond schemes. The Committee said that stronger action should have been taken earlier, with financial promotions obliged to disclose the risks in similar sized print to the best case scenarios highlighted for the investments.

As early as 2002³⁴ the Panel warned over the risk posed by the inappropriate marketing and sale of precipice bonds and the losses being suffered by consumers. The Panel thought that the FSA seem to have been wrong-footed by the widespread inappropriate sales of precipice (high income) bonds and must act faster in future.

In 2003³⁵ the Panel wanted the new disclosure regime to be extended to new and complex products rather than just packaged products as proposed.

³⁴ 2002/03 Consumer Panel Annual Report pp 7, 20, 22

³⁵ 2003/04 Consumer Panel Annual Report pp 14, 16

Appendix 5 Case Study - Endowment Mortgages

A lack of regulation and industry malpractice led to consumer detriment. Endowment mortgages highlight the need for comprehensive regulation and for business model reviews of both financial products and their marketing.

Endowment mortgages are (or were) interest only mortgages sold alongside an investment policy designed to pay off the mortgage capital at the end of the term. The policy was usually invested in shares or bonds and was often sold as a low risk or no risk product likely to generate a surplus at the end of the term, often with no discussion of the risks involved or alternative repayment vehicles available. However, in practice many policies failed to produce the promised returns, resulting in a shortfall of capital to pay off the mortgage.

The total extent of the shortfall is not known.

FSA Action

The FSA conducted an industry wide review of the mortgage market in 2000 and this resulted in fines for companies found guilty of mortgage endowment misselling. The FSA ensured that endowment mortgage holders received an FSA factsheet from their provider and through the ABI policy holders were also sent a standard format re-projection letter. Fact sheets on complaining were also made available. Concerns were raised at the time that the onus was on householders to prove that they had been mis-sold a product 10-15 years previously.

Regulatory Shortfall

Endowment mortgages were a subject of concern to the Consumer Panel from its inception in December 1998. As we detailed to the Treasury Committee inquiry³⁶ the Panel consistently pressed the FSA to act faster to investigate warnings and to investigate more thoroughly the firms which had a greater concentration of problem endowments. The Panel also called on the FSA to make sure that consumers understood the issues that affected them and their savings, and were informed of their rights, as well as the limitations of compensation.

The Panel expressed the view to the Treasury Committee that the FSA had relied too much on the reassurances of the industry³⁷. The Panel called for the FSA to commission mystery shopping³⁸ exercises in our 1999 Annual Report.

Re-projection research commissioned by the Panel in 2000³⁹ revealed that over half of respondents believed that their endowment mortgage was guaranteed to pay off their mortgage. As a result of this research, which revealed some consumer confusion, the Consumer Panel also undertook a lot of work in assisting the FSA to reformat the re-projection letters sent to those with endowment mortgages to make sure consumers understood the implications of their situation.

³⁶ 25th November 2003 Consumer Panel submission to the House of Commons Treasury Committee

³⁷ Consumer Panel 2003 Treasury Committee Submission para 45, p11

³⁸ Consumer Panel 1999 Annual Report pp 24, 31

³⁹ Consumer Panel Mortgage Endowment Reprojection Research Report, Autumn 2000

Appendix 6 Case Study – Self Certification Mortgages

Weak regulation and poor lending practices led to consumer detriment. Consumer Panel action has included encouraging providers to liaise properly with consumers and the FSA to increase regulatory pressure on firms.

The recent worldwide financial crisis was in part caused by instability from mortgage market debt as mortgages had been sold to a large number of customers who could not afford them. In the UK the significant growth in the number of self-certified mortgages contributed to this problem.

FSA Action

The FSA took over regulation of the Mortgage Market on the 31st October 2004 following the Treasury announcement of January 2000. FSA regulation replaced the voluntary mortgage code with the Mortgage Conduct of Business Rules (MCOB). These were extended to cover home purchase and reversion plans with effect from the 6 April 2007.

Regulatory Shortfall

In 2005⁴⁰ the Panel rated the FSA weak on regulation of self-certification mortgages and pointed out that the results of the FSA thematic work on self certification mortgages could hide a much bigger problem than the FSA had suggested.

The Panel also reported that the FSA and CML data indicated a worrying level of interest-only mortgage arrangements being made where the lender had no knowledge of how the capital would be repaid at the end of the term. The Panel asked the FSA to undertake thematic work.

In 2006⁴¹ the Panel reiterated its concern over mortgage lending and mortgage advice and it encouraged the FSA to increase regulatory pressure on firms to improve the mortgage market.

The Panel also worked with the Ministry of Justice which brought out a mortgage arrears pre-action protocol in November 2008 designed to ensure that repossession was the last resort of lenders.

⁴⁰ 2005/06 Consumer Panel Annual Report para 2.11 and 2.13

⁴¹ 2006/07 Consumer Panel Annual Report para 2.20

Appendix 7 Case Study – Banking regulation

Disjointed regulation of the banking sector resulted in consumer detriment from poor business practices. The financial crisis and lobbying by the Consumer Panel and others eventually resulted in FSA taking over regulation of retail banking from the Banking Code standards board.

The FSA only took over retail banking conduct regulation for deposit taking in November 2009. Before the FSA took over, retail banks had regulated their conduct themselves through the Banking Code Standards Board. By 2008, it had become apparent that self-regulation was not working well and the implementation of the European Payment Services Directive provided an incentive for the FSA to take over the regulation of deposit taking. However, the OFT continued to be responsible for the regulation of credit and a modified form of self-regulation of credit has continued under the Lending Code Standards Board.

For many years banks had charged customers for unauthorised overdrafts; however, from 2006⁴² the issue of the size and scale of charges became increasingly controversial with the OFT indicating that some of the charges might be illegal. A series of out-of-court settlements followed with large numbers of consumers making claims before the OFT took a test case in 2007. The case went up to the Supreme Court in 2009 with the ruling that the 1999 consumer contract regulations used by the OFT did not apply to bank charges to which customers had agreed. However, the court left open the option for the OFT to use other provisions to scrutinise bank charges.

FSA Action

The FSA has been hamstrung by not being in charge of all banking conduct of business. An example of the problems this created is that the notification of an unauthorised overdraft is regulated by the FSA, but subsequent communications come under the OFT. However, the FSA took action against poor complaint handling in banks after conducting a review which followed the publication of aggregate complaints data in September 2009.

Regulatory Shortfall

In 2008⁴³ the Panel expressed concern that legislation was preventing the FSA from closely supervising bank charges.

In 2009⁴⁴ the Panel reported that it was disappointed by the Supreme Court ruling on unauthorised overdraft charges. It emphasised that this made the issue unclear for consumers and also that it would result in unfairly high charges to vulnerable people. The Panel asked the FSA to clarify this area. The Panel also noted its concern about the lack of clear advice to consumers wanting to challenge bank charges. The Panel also reported that it was worried about banks using the OFT unsuccessful court action as a reason to reject claims.

The Consumer Panel remains concerned that the separation of responsibility between the FSA and the OFT with regard to consumer credit means that there is disjointed regulation. We would like to see the FSA's successor given power over consumer credit.

⁴² 2007/08 Consumer Panel Annual Report p17

⁴³ 2008/09 Consumer Panel Annual Report pp 3,13

⁴⁴ 2009/10 Consumer Panel Annual Report p14

Appendix 8 - US Financial Services Regulatory Reform

The US regulatory system is characterised by a proliferation of organisations regulating different sectors of the market and performing interrelated functions. This presents some complexities when both comparing the system to European models of financial services regulation and indeed in implementing regulatory reform.

The main changes enacted by the Obama administration are contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act. The long titles sets out the overall aims of the legislation:

To promote the financial stability of the United States by improving accountability and transparency in the financial system, to end “too big to fail”, to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes

Dodd-Frank came into force on the 21 July 2010, however, many of its provisions⁴⁵ will only come into force over the next 18-months. In general terms, Dodd-Frank is consistent with the direction of reform adopted elsewhere in the world and represents the largest change in the regulatory structure in the US since the Glass-Steagall Act of 1933.

The key provisions of Dodd-Frank are:

- Financial Oversight Council (FSOC) charged with identifying and addressing systemic risks
- Consumer Financial Protection Bureau - with powers to regulate individual firms
- Enhanced powers for the Federal Reserve to impose capital, leverage and liquidity requirements on individual firms and The Volker Rule – a prohibition on banks engaging in proprietary trading
- Living wills – a liquidation process for systemically significant firms to end taxpayer bailouts
- Stronger regulation around corporate governance including remuneration
- Regulation of hedge funds, derivatives and credit rating agencies and non-bank financial institutions.

Financial Stability Oversight Council

The Financial Stability Oversight Council (FSOC) has been created to identify risks in firms and from market activities that threaten the financial system as a whole and has an information gathering arm the Office of Financial Reporting (OFR).

The reason for creating the FSOC was to deal with the perceived failure in the system as described by the Washington Post on 26th January 2009⁴⁶:

⁴⁵ 243 rulemaking and 67 studies according to US law firm Davis Polk

⁴⁶ Neil Irwin and Binyamin Appelbaum, Washington Post Staff Writers

An abundance of federal agencies regulate the financial industry. But no agency is responsible for understanding or containing the risks affecting the financial system as a whole. In fact, none even has a complete picture of the financial markets.

The FSOC is empowered to:

- Bring non-bank financial institutions under the regulation of the Federal Reserve
- Recommend enhanced prudential standards which the Federal Reserve and others must consider, including implementing rules on firms whose size and complexity could pose risks of market stability
- Approve Federal Reserve Decisions to require firms to divest some of their holdings
- Require companies to report on certain issues
- Monitor and report on domestic and international financial regulatory proposals and report and advise congress
- Set aside any rule proposed by the Consumer Financial Protection Bureau (see below)

The FSOC must

- Report to Congress annually its activities, market stability, regulatory developments and emerging risks
- Consult with foreign regulators on proposals to impose additional standards on foreign firms

FSOC Membership

The membership of the FSOC includes the Treasury Secretary (Chair), and the heads of the Federal Reserve, SEC, Office of Comptroller of Currency (OCC), Bureau of Consumer Financial Protection, Federal Deposit Insurance Corporation (FDIC), Commodities Futures Trading Commission (CFTC), Federal Housing Finance Agency (FHFA, National Credit Union Association (NCUA) and the non-voting chairman of the OFR.

Office of Financial Reporting

The OFR is a self-funded, through fees on large banks, and largely independent organisation with the power to gather information from financial market participants and to require standardisation of financial information for reporting to the OFR and other regulators.

Significantly, its information gathering powers are broad and all data collected will be subject to the Freedom of Information Act. Although there are some complexities in the legislation and exemptions for publication of supervisory information, the OFR is required to publish, in a manner that is easily accessible to the public, databases on financial companies and financial instruments, as well as formats and standards for OFR data.

Bureau of Consumer Financial Protection (BCFP)

The creation of the BCFP is still one of the more controversial pledges of the Obama administration, as has been seen by the recent controversy over its director⁴⁷. The BCFP is established within the Federal Reserve but will be independent with its director appointed by the President and approved by Congress. Funding will be derived from a capped percentage of the Federal Reserve's operating profit and will therefore be independent from approval or scrutiny by Congress. Penalties levied by the CFPB will be held in a separate fund and used to compensate victims.

BCFP Aims and Objectives

The BCFP⁴⁸ is tasked with:

The Bureau shall seek to implement and, where applicable, enforce Federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive.

Five further objectives are specified⁴⁹:

- 1) *consumers are provided with timely and understandable information to make responsible decisions about financial transactions;*
- 2) *consumers are protected from unfair, deceptive, or abusive acts and practices and from discrimination;*
- 3) *outdated, unnecessary, or unduly burdensome regulations are regularly identified and addressed in order to reduce unwarranted regulatory burdens;*
- 4) *Federal consumer financial law is enforced consistently, without regard to the status of a person as a depository institution, in order to promote fair competition; and*
- 5) *markets for consumer financial products and services operate transparently and efficiently to facilitate access and innovation.*

BCFP Powers

The BCFP lacks an explicit mandate to ensure stability of firms or the financial system as a whole. However, other bodies which do have this mandate have a check on the BCFP's powers.

The BCFP has exclusive rulemaking, examination and enforcement powers for depository banks with assets over \$10 billion and for many non-bank financial institutions. However many firms are exempted, including those regulated by other bodies⁵⁰. For smaller banks, the BCFP remains the rulemaking authority but will share examinations and enforcement remains with prudential regulators. However, the BCFP does have rule making powers with

⁴⁷ <http://www.washingtonpost.com/wp-dyn/content/article/2010/09/17/AR2010091706597.html>

⁴⁸ Chapter X, Subtitle B, s1021(a) HR 4173 pp 604 – 605 Dodd-Frank Act

⁴⁹ Chapter X, Subtitle B, s1021(b) HR 4173 p605 Dodd-Frank Act

⁵⁰ E.g. insurance firms and broker-dealers. Specific exclusions include auto dealers, accountants and retailers of non-financial goods

regard to new consumer financial protection provisions and existing Federal consumer financial protection laws and provisions currently spread amongst other federal agencies.

A member of the FSOC can stay the implementation of a BCFP rule and a 2/3 vote of the FSOC can set it aside.

Information collecting powers of the BCFP extend annual and specimen reports as well as answers in writing to specific questions. Prudential regulators also have to make their reports and examinations available to the BCFP.

A new consumer hotline is also to be created for consumers to report problems with financial products and services.

BCFP Accountability

The BCFP director is liable to testify at semi-annual Congressional hearings and the BCFP must also submit a report regarding its actions over the preceding period and plans for the upcoming period as well as report on problems faced by consumers in obtaining financial services and an analysis of the efforts of the BCFP in ensuring fair lending. Annual audits are also provided for in the legislation and budget must be submitted to the Office of Management and Budget.

Additionally the BCFP must publish an annual report and assess each of its rules within five years and submit a report to congress on internal training and work-force development.

Appendix 9 - Financial Regulation in the Netherlands

Dutch financial services regulation is based on function-based supervisions rather than sector-based supervision due to the increasing complexity of the financial products on offer in the Dutch market from the late 1990s.

DNB Netherlands Central Bank (De Nederlandsche Bank)

The DNB is the prudential regulator in the Dutch system. It is tasked with prudential supervision of financial institutions including banks, credit institutions, pension funds and insurance companies as well as monitoring systemic risk and financial stability.

DNB aims and objectives⁵¹:

- Financial stability
- Monetary policy
- Secure payments
- Prudential supervision – financial institutions must be sound and reliable
- Economic adviser to the Dutch Government

DNB powers

Aside from prudential regulation the DNB is also responsible for authorising firms and for monitoring financial institutions as well as co-operating with international bodies.

DNB Accountability

Day to day management is carried out by the Governing Board of the president and three executive directors. There is also a ten member Supervisory Board which oversees DNB management and general operations including approving its budget as well as a 14 member Bank Council which serves as a sounding board for the Governing Board.

The DNB is independent of Government and maintains secrecy with regard to monetary policy and prudential supervision to protect the financial system.

AFM - Netherlands Authority for the Financial Markets (Autoriteit Financiële Markten)

The AFM is responsible for financial markets and conduct of business regulation as well as authorising all firms before they are allowed to provide certain services. It describes itself as an independent supervisory authority for the savings, borrowing, investment, pension and insurance markets and strives to:

...strengthen the confidence of consumers and companies in the financial markets, both national and international⁵²

Moreover, the AFM provides consumer information on its website and states that that:

Consumers have to be able to rely on financial enterprises acting decently and honestly⁵³.

AFM aims and objectives are threefold:

⁵¹ <http://www.dnb.nl/en/about-dnb/duties/index.jsp>

⁵² <http://www.afm.nl/en/consumer/afm.aspx>

⁵³ <http://www.afm.nl/en/consumer/vertrouwen.aspx>

- making the financial markets more accessible
- promoting the smooth operation of the financial markets
- promoting confidence in the financial markets

AFM Powers

The AFM has a wide range of powers including information gathering and providing information to consumers. They can also:

- Issue an instruction or a public warning
- Withdraw permission
- Report firms to the public prosecutor
- Impose fines and penalty payments
- The AFM publishes lists⁵⁴ of firms and individuals which consumers should be wary of doing business with as well as consumer financial educational information⁵⁵
- Financial Markets Information Line which consumers can call to complain or seek information. The AFM co-operates with the DNB on this.

AFM Accountability

The AFM falls under the jurisdiction of the Ministry of Finance and is therefore described as a “semi-governmental” agency under the Dutch system.

Co-operation between the AFM and the DNB

The AFM and the DNB have a statutory duty⁵⁶ to minimise unnecessary costs by sharing data and also have a co-operation covenant, reviewed annually, which is designed to provide a framework for co-operation. This includes agreement on:

- Respective powers and responsibilities of each supervisor
- Defines which aspects of financial institutions come under conduct as opposed to prudential regulation
- Rules for consultation and information sharing

Co-operation between the bodies includes quarterly board level meetings and issue specific working groups as well as joint supervisory teams for large institutions and notification procedures and consultation ahead of investigations.

⁵⁴ Only available in Dutch: http://www.afm.nl/nl/consumenten/risico/waarschuwingen_afm.aspx

⁵⁵ <http://www.afm.nl/en/consumer/producten.aspx>

⁵⁶ 2007 Financial Supervision Act

Appendix 10 - The Financial Services Consumer Panel

We are an independent statutory body, set up to represent the interests of consumers in the development of policy for the regulation of financial services.

We work to advise and challenge the FSA from the earliest stages of its policy development to ensure they take into account the consumer interest.

The Panel also takes a keen interest in broader issues for consumers in financial services where it believes it can help achieve beneficial change and outcomes for consumers.

Since the Panel was established in 1998, we believe the Panel has helped deliver significant, positive benefits for consumers. We support the FSA where we believe policies can help consumers and challenge the FSA forcefully when we feel consumers would be disadvantaged.

Members of the Panel are recruited through a process of open competition and encompass a broad range of relevant expertise and experience.

Further information about the Panel can be obtained from the Panel's website:

<http://www.fs-cp.org.uk/>