

Kay Blair Speech

CML Annual Scottish Lunch

Friday 8 March 2013

First of all, let me say how delighted I am to be here today as the guest of the CML and at this renowned Edinburgh institution, the Caley. As some of you may know, this wonderful hotel first opened its doors to the eager customers of the Caledonian Railway in 1903.

This hotel has seen many strange events over the last few decades. Now I hesitate to mention horses these days in proximity to any catering facility. However you might be interested to know that the ‘singing cowboy’ Roy Rogers visited this hotel in 1953 and allegedly rode or led his horse Trigger on the main stairs – much to the delight of his many fans.

But I am not here to talk about the Caley's history.....rather to talk about my expectations of the regulation of financial services in future. I would also like to explain how my views have been shaped by my experiences with the Financial Services Consumer Panel over the past six years . Back in 2006 when I joined the Panel¹ economic times were allegedly, and in the words of the FSA's then chairman, “benign”.

Life appeared pretty rosy for many. While mojitos and cosmopolitans were **the** drinks of the day and fashion stakes hit the heights with oversized bags, sunglasses and skinny leggings,

¹ 1st September 2006

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ordinary people revelled in a credit boom never before experienced. Spending frenzies were considered normal. Mortgages of five times salary, or 120% LTV were not uncommon....a far cry from my first mortgage foray when I had to beg a broker to find us a mortgage at only 3 times salary.

In London, Chancellor Gordon Brown had proclaimed the end of boom and bust. The hedge funds were doing brisk business in the offices and wine bars of Mayfair and the cosy consensus was that the era of light-touch, principles- based regulation had propelled the City of London to global economic stardom.

In hindsight the omens were there. As far back as 2001 the Federal Reserve had slashed interest rates leading to a housing bubble. By 2006 US interest rates had risen to such an extent that the housing market was stalling and sub-prime borrowers were starting to default on their loans. Incidentally, 2006 was also the year when the planet Pluto was formally demoted to space junk.

Over the last few years we've seen junk status awarded to a host of leading financial stars. Light touch regulation has fared no better.

Just one year into my tenure on the Consumer Panel ² - and customers were queuing around the block to withdraw their money from Northern Rock in scenes reminiscent of the Great Depression. The collapse of Northern Rock was followed in 2008 by Bear Sterns³,

² 14th September 2007

³ Sale completed to JP Morgan Chase on the 30th May 2008

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Merill Lynch⁴ and finally Lehmans⁵ became the largest bankruptcy in US corporate history. In the UK hallowed names like RB S and HBoS fell spectacularly from grace.

So here we are in 2013 still in the jaws of a double-dip recession, with some speculating it could yet be a triple dip.

On the regulatory front light-touch regulation has given way to a new regime incorporating rules and principles and based on the new twin peaks approach enshrined by the 2012 Financial Services Act.

The FSA will shortly be replaced by the Financial Conduct Authority described somewhat boldly as having a philosophy of “shooting first and asking questions later”. Perhaps our errant cowboy Roy Rogers could have written a song about that.

Prudential regulation now moves to the Prudential Regulation Authority – part of the Bank of England. Across the EU the new European Supervisory Authorities are making their mark. Sitting above national regulators, and focusing on banking, investments, pensions and insurance, they are aiming to drive better industry standards and enhanced consumer protection. I currently advise one of them, EIOPA, in Frankfurt where we are entrenched in interim measures around Solvency II and getting a better deal for consumers from the insurance directive, IMD II.

Perhaps it would be helpful at this stage to explain why the role of the Panel in representing the consumer perspective is so critical. The Consumer Panel was established in 1998 to advise the FSA’s predecessor, the Personal Investment Authority (PIA). It was given a statutory footing under the Financial Services and Markets Act 2000 (FSMA) alongside a

⁴ Sold to the Bank of America on 14th September 2008

⁵ 15th September 2008

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practitioner Panel. There is now also a Smaller Businesses Practitioner Panel and will soon also be a Markets Practitioner Panel.

We exist to advise, support and challenge the FSA with consumer interests at the forefront of our thinking,.. While most of our work is directly related to the work of the FSA - and often of necessity goes on behind the scenes -- we do take an interest in other areas which we see as critical to protect consumer interest . It has also meant that, although we have engaged with the regulation of banking conduct, we have not until recently given much attention to credit, since this has been regulated by the OFT and will only transfer to the FCA in 2014.

The Panel benefits from a clear insight into the regulator's activity and our privileged access makes it possible to influence policy making from the earliest stages. We also have a very able secretariat and policy officers who help us provide effective evidence-based arguments to help counterbalance the huge lobbying power and market knowledge of the industry. We engage regularly with other consumer groups to channel advice and concerns to the FSA, particularly with regard to emerging consumer risks.

In previous years we have focused our activity on major policy areas such as the Retail distribution Review (RDR) - where we have always been hugely supportive of the FSA's aim to raise professional standards and end commission bias, even though there may be some short-term disadvantages – and, of course, the Mortgage Market Review (MMR) where we have both agreed and disagreed over the years with the FSA's proposals.

MMR

Given today's audience, it might be helpful to dwell for a moment on the Mortgage Market Review and explain our position. The Panel has certainly been supportive of the need to strengthen regulation of the mortgage market. There was a need to mitigate against irresponsible lending and to address irresponsible borrowing by over exuberant consumers.

However, we were sceptical about the FSA's approach which we found, certainly to begin with, overly focused on the vulnerable and which we considered to be dismissive of the potential impact on the great majority of creditworthy consumers.

We therefore spent a great deal of time grappling with the various proposals and the basis on which they had been formulated. In the end we boiled down our advice into 6 key areas:

- 1) We wanted to see effective regulation to help consumers – here we were concerned that the FSA's proposals while going some way towards ensuring an end to irresponsible lending were still potentially constraining for the millions of responsible borrowers.
- 2) Regulatory policy we believed should take account of wider social and economic implications – in particular, we were keen to see greater evidence of joined up thinking and evidence of consideration of the potential changes to the home-ownership population brought about by the MMR.
- 3) In our view lenders needed to be required to judge affordability and suitability for individual consumers – the removal of both the originally proposed buffer on standard affordability tests for the credit impaired and the proposal to restrict the maximum

assessable mortgage term to 25 years were two examples of the way the FSA actually revised its approach in this regard. In these times of increased longevity and changing working patterns, mortgage terms of only 25 years seemed to us far too restrictive.

- 4) We wanted to see transitional arrangements which took account of the implications of the changes for all segments of the market – this area remains a concern and is one I will come back to. We are already seeing firms in the market move to restrict loan-to-value and loan-to-income ratios. For some this is entirely appropriate and brings back memories of yore. But it is problematic for those ‘mortgage prisoners’ unable to exit their current agreements if they find themselves paying significantly higher interest rates with no options to move elsewhere. We believed the FSA needed to strengthen its proposals in this regard and we put forward a more robust approach to what it ended up with which I will describe in a minute.

- 5) We also sought a future regulatory structure responsive to consumers’ needs – The MMR did not dispel our concern that insufficient consideration had been given to the potential regulatory overlap between the FSA’s proposals and the macro-prudential interventions that the Financial Policy Committee might take to avert an unsustainable lending boom. The FPC has recently called for more analysis and public debate, which we still believe the FSA should be leading.

- 6) And finally we wanted to see a more balanced debate which could overcome the polarised views on the mortgage market – We made the point that the MMR debate became unhelpfully polarised between those organisations that represented the interests of

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vulnerable consumers and industry representatives who focused on the overall market.

We tried to steer the middle course.

In the end the final rules were far less contentiously received by both sides, evidence of the far more proportionate approach taken by the regulator. We were certainly more supportive of where the regulator ended up.

However and there is usually a however as you well know, we were not completely happy with the final proposals...

I will now return to the issue of mortgager prisoners – borrowers who are ‘trapped’ with their current lender. The risk of being charged a higher interest rate because a consumer is unable to move their mortgage elsewhere is particularly acute. This applies both to borrowers who are already trapped, because they do not meet current tightened lending criteria, and those who may be trapped in the future following implementation of the MMR.

In our advice we said that we were not convinced that the FSA’s Unfair Contract Terms powers, and the additional requirement for firms to treat their customers fairly, were sufficient to mitigate the problem.

We therefore suggested a specific rule to protect ‘mortgage prisoners’, given that these consumers who become 'trapped' with their current lender are particularly vulnerable as the usual market forces of competition and consumer choice will not apply to them. In the end the FSA took the decision to introduce its own well intentioned evidential provision in this space but we would like to see the new MCOB provision[1] revised to make sure that it

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offers clear protection to mortgage prisoners, and to remove any ambiguity as to what it means in practice.

At the moment in a relatively benign interest rate environment our concern about this group of consumers has perhaps not rocketed to the fore, but it is bound to be something which becomes more acute as interest rates inevitably rise again at some point.

Indeed, it is interesting that last week the Bank of Ireland announced that 13,500 customers on tracker loans pegged to Bank Rate will see repayments more than double – and in some cases allegedly rise fivefold, according to this week's Sunday Times. This increase comes despite Bank rate remaining at 0.5% since March 2009.

Of course the Bank of Ireland cites numerous reasons for the increase. Others lenders no doubt will have similar clauses allowing them to tread similar paths. So despite falls in the rates banks pay for their borrowing, consumers could again face steep hikes.... and many consumers will not be able to switch to more competitive deals.

I ask you, is this what treating customers fairly means?

On to other matters. Of course we are interested in the forthcoming European Mortgage Directive as well and active on the Treasury stakeholder group looking at the implications for this for UK consumers. We are particularly keen that it integrates as seamlessly as possible with the MMR.

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In just under a month the new Financial Conduct Authority will assume its new powers and the Consumer Panel will continue to advise, support and challenge. Given issues around misselling - for instance PPI -, low value products in many areas and what also seem to be excessively high charges in others, we will be keen to see a more intrusive and effective regulator. We are reasonably encouraged by early pronouncements ..intervening earlier around poor product governance, taking robust enforcement action, having a firmer view of what value for money actually means, holding senior management of firms to account, encouraging cultures with what we would see as the right kind of behaviours and attitudes. However, we have cautioned that strong rhetoric must be matched by strong action and the FCA must ensure that it has sufficient resources at the appropriate level, and with the necessary skills and expertise, to deliver what it has promised. The effectiveness of a regulator is so dependent on the knowledge of its people and its appetite to effect positive change.

Our priorities for the FCA focus on

- The need for the FCA to prioritise ruthlessly as an ambitious agenda could overstretch limited resources and enable opportunistic financial services firms to push the limits of acceptable conduct;
- the case for an even higher level of penalties that would effectively remove firms' incentive to engage in practices harmful to consumers; and
- analytical resources, rule-making and enforcement powers that are deployed vigorously to promote effective competition, to the benefit of consumers.
- A clearer articulation of what the concept of Treating Customers Fairly actually means

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Aside from the MMR and the FCA's effectiveness, we are also focusing on General insurance, decumulation and credit.

On the latter, credit, we welcome the plan to transfer responsibility for the regulation of consumer credit to the new FCA. We see a single regime as a definite improvement. It has always struck us as odd that a bank account in credit has one regulator while if in debit it has another. However, it is essential that consumer protections standards should be maintained, and ideally enhanced, under the transfer.

Some of the current issues and problems consumers face in the general insurance market are concerning, whether that be when buying a product, renewing a product or when making a claim. While recognising the many advantages consumers perceive when using price comparison websites, even if they have to put up with rotund opera singers or meerkats, the emphasis of those sites on price may lead to a lack of focus on quality. And we are concerned at the hollowing out of products when consumers come to renew and some of the incentive structures and poor service issues around claims processes and complaints handling. So lots of pre and post sales issues for us to look at.

We also have concerns about people's experiences when they come to annuitise. For instance, a lack of affordable advice at what is a particularly critical time when people need to make the right decisions. Why, for instance, don't more people make use of the Open Market Option to shop around for the best possible annuity. This can be particularly advantageous. As well as getting a better deal which can translate into thousands of pounds of additional income and possibly a different more appropriate type of annuity, not enough people shop around. Admittedly, existing providers don't always make it easy for retirees: indeed the wads of unintelligible jargon I have seen sent out to those approaching

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annuitisation beggars belief. But it could make a real difference and is something we – and we hope the FCA – are alert to. In terms of pensions savings, Auto Enrolment is a good step forward, particularly if more people can see the benefit in saving more for retirement.

But there are still pensions issues around high charges, poor governance and lack of engagement.

And Let's not forget Europe

Last year former FSA Chief Executive Hector Sants commented ⁶that “*Essentially, the UK is moving to become a supervisory arm of Europe*”.

Increasingly, the regulation of financial services is being driven by European legislation. The industry is well represented and lobbies hard to protect its position. We are just as keen to ensure the voice of the consumer is heard, understood and taken into account.....thus our engagement on various groups and at various levels within the EU and its relevant organisations.

Lunch is looming, so let me conclude by emphasising again our high expectations of the new FCA. Of course, it will need to have good people, able to identify and assess risk effectively, able to supervise intelligently and make good judgements. It has the tools to be a more effective conduct regulator. It also needs to have the appetite. So far the omens look good.

As its CEO Martin Wheatley said recently...

The FCA offers a huge opportunity for the regulator and firms to start afresh, and work in partnership to reset how we deal with conduct in financial services. We see it as the role of the regulator to not only make the relevant markets work well but also to help firms get back to putting their customers at the heart of how they do business.”

⁶ 7th February 2012, [*Essentially, the UK is moving to become a supervisory arm of Europe*](#)

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Martin went on to say that “FCA will aim to learn the lessons of previous issues such as PPI mis-selling by taking earlier and more decisive action to deal with problems early. It will devote more resources to analysing possible risks and looking at cross-industry issues to assess the cause of problems.

This approach will be backed by new powers that will allow the FCA to ban products and promotions if it believes that they create risks to consumers. The FCA will also promote effective competition in the interests of consumers. .

On that optimistic note I will conclude.

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