

Financial Services and Markets Bill

Financial Services Consumer Panel memorandum to:
Joint House of Commons and Lords Scrutiny Committee

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Summary

The Financial Services Consumer Panel makes the following recommendations to the Joint Committee on Financial Services and Markets:

- a. **Consumer protection objective:** Clause 5(2) (c), which enshrines the principle of caveat emptor, should be removed (*paragraph 3*).
- b. **Suitability requirement:** an additional objective should be introduced requiring that products are suitable for the purpose for which they are bought (*paragraph 5*).
- c. **Financial exclusion:** the FSA in carrying out its general functions should have regard to the needs of customers who are disadvantaged (*paragraph 7*).

- d. **Partnerships:** the FSA in carrying out its general functions should have regard to whether it should work alone or in partnership with other bodies (*paragraph 8*).
- e. **Consumer Panel:** the relevant clause of the Bill should secure: the independence of the Panel; its powers to provide advice, make recommendations, evaluate the effectiveness of the FSA and to publish reports; the provision of resources adequate to the Panel's needs; and the Panel's ability to spend its budget on investigating any aspects of financial services which impact on consumers. The FSA's annual report should include the Panel's assessment of the FSA's effectiveness in meeting its consumer protection and public awareness objectives (*paragraphs 9 and 10*).
- f. **Mortgages and long-term care insurance:** must be included in the FSA's scope from the outset (*paragraphs 11-13*).
- g. **Deposit taking and general insurance:** the flexibility in the Bill to introduce conduct of business regulation if it became necessary must be retained (*paragraph 14*).
- h. **OPRA:** the pension functions of the FSA and OPRA should be subject to review (*paragraph 16*).
- i. **Authorisation of approved persons:** the FSA should have powers to check criminal records as a matter of course and should be required to establish a public register of approved persons and prohibited persons (*paragraph 17*).
- j. **Publication of intervention action:** there should be a presumption that the FSA's intervention action will be published to make consumers aware of problems (*paragraph 18*).

- k. **Single Ombudsman Scheme:** extensions to the compulsory jurisdiction should not be at the discretion of the FSA and the power to enable the Scheme to charge consumers must be deleted (*paragraphs 21 - 23*).

Introduction

1. This Memorandum is submitted by the Financial Services Consumer Panel to the Joint Committee on Financial Services and Markets. The Financial Services Authority (FSA) established the Consumer Panel to advise the FSA Board on the interests and concerns of consumers and to report on the FSA's effectiveness in meeting its consumer protection and public awareness statutory objectives. There are eleven members of the Panel representing a broad range of consumer interests. The Panel is independent of the FSA - it can raise its own concerns, initiate its own research and publish its own reports.
2. The Panel's submission is organised under the following headings:
 - Regulatory objectives
 - Accountability and the Consumer Panel
 - Scope of the FSA
 - Authorisation, enforcement and investigative powers
 - Single Ombudsman Scheme
 - Single Compensation Scheme.

Regulatory objectives

The protection of consumers

3. The Panel welcomes the inclusion of a consumer protection objective for the FSA. However, this is undermined by the qualification at Clause 5 (2) (c) of the draft Bill: *"the general principle that consumers should take*

responsibility for their own decisions". This should be removed. It introduces a principle that is absent from all consumer protection legislation and undermines the main purpose of the objective. If, as stated in the Treasury's progress report, the purpose of this clause is not to provide absolute protection to consumers, this qualification is unnecessary as Clause 5(2)(a) and (b) already cover this.

4. We do not support the Treasury's justification for the retention of Clause 5(2) (c):

- the Treasury states that it is intended that this clause is a presumption which will vary according to different circumstances – different circumstances are already covered in Clause 5(2)(a) and (b);
- the Treasury suggests that this clause prevents the risk of the moral hazard of consumers thinking that if they use the services of an authorised person their interests will be fully protected. There is absolutely no evidence of a moral hazard in the past without such legislation.

A suitability requirement

5. The FSA should have an additional regulatory objective that mirrors existing consumer protection legislation in other areas to ensure that financial services are fit for purpose. We support the proposal made by the National Consumer Council for such an objective. In our view it should be a requirement in the Bill that:

- products are reasonably suitable for the purposes for which they are commonly bought or for any particular purpose which the buyer makes known to the provider (a fitness requirement); and
- products do not put the consumers' investment at risk, other than in ways it can be shown were indicated prominently before purchase (a safety requirement).

6. The inclusion of such an objective does not involve any radical changes from existing regulation since it is already enshrined in the Personal Investment Authority's suitability requirements. It would not require the FSA to have an explicit statutory role to improve the quality of products. Nor would it require the FSA to pre-vet all products. The Treasury argues that protecting consumers can be achieved by other means but this was not easy with the problem of "unsafe" home income plans, which took time and difficulty to resolve.

Matters the FSA should have regard to

7. The Panel recommends two additions to the list of matters that the FSA should have regard to in carrying out its general functions. Firstly, we recommend the list of matters should require the FSA to take account of the needs of those consumers who are disadvantaged in the context of the matter under consideration. We recognise that reducing financial exclusion and improving access to financial services raises wider social issues for the Government to address. It is important, nevertheless, that the FSA has regard to the Government's objectives in this area when carrying out its functions.
8. The second requirement that should be added to the list of matters that the FSA should have regard to in carrying out its general functions is whether it should work alone or in partnership with other bodies such as advice agencies and local authorities (eg trading standards authorities). Such partnerships could bring a range of benefits including:
 - giving the FSA access to information and complaints from consumers experiencing problems on the ground;
 - use of local agents to disseminate material to the public.

Accountability and the Consumer Panel

9. We welcome the Government's announcement that the Bill will contain a statutory requirement for the FSA to establish a Consumer Panel. The FSA has appointed a Consumer Panel following an open recruitment process based on Nolan principles and provided the Panel with staff support and a budget to carry out its own work and commission research. The relevant clause of the Bill should reflect this good practice by securing:

- the independence of the Consumer Panel whose members should be appointed following open competition;
- the Panel's powers to provide advice, to evaluate the effectiveness of the FSA in meeting its statutory public awareness and consumer protection objectives, to make recommendations, to conduct research and to publish its work;
- a requirement on the FSA to provide resources adequate to the Panel's needs;
- the Panel's ability to spend its budget on investigating any aspects of financial services which impact on consumers, in terms of the priorities it sets for itself; and
- a requirement to include in the FSA's annual report, the Panel's assessment of the FSA's effectiveness in meeting its statutory objectives.

10. In reviewing the effectiveness of the FSA itself, the non-executive committee should have particular regard to the findings of the Consumer Panel and should comment on these.

Scope of the FSA

11. Despite the Government's rhetoric it is regrettable that the Bill fails to provide a one-stop shop for consumers in terms of the FSA's scope. The Government's announcement to extend the compulsory jurisdiction of the Single Ombudsman Scheme recognises the importance of a one-stop shop for redress but the Bill fails to deliver this in other areas of regulation. We acknowledge that the type of regulation can vary between different markets but call for the scope of the FSA to be extended. We recommend that the remit of the FSA is extended to include mortgages and long-term care insurance because of the complexity of these products and the vulnerability of consumers who are purchasing them.

12. We recognise that the Treasury is waiting to evaluate the effectiveness of the Mortgage Code but believe that mortgages must be included in the FSA's remit from the outset for the following reasons:

- a mortgage is one of the most significant financial transactions people make;
- it is estimated there are about 4,000 different mortgages for consumers to choose from – the choice is bewildering and complex;
- mortgages are purchased infrequently by inexperienced consumers who often have to make decisions very quickly;
- there is evidence of the failure of lenders and intermediaries to comply with their own Code;
- a voluntary body is unlikely to be able to take effective action against large companies who are non-compliant (past experience of regulators such as LAUTRO and PIA suggest that it is necessary to fine large organisations for non-compliance);
- there has been a growth in new types of home income plans many of which are on the boundary between investment products which the

FSA will regulate and mortgages that may fall outside the FSA's scope;
and

- it is difficult for the FSA and non-statutory bodies to provide effective consumer protection because of information sharing problems (see paragraph 20).

If mortgages are regulated by the FSA, account will need to be taken of the relationship with the Consumer Credit Act.

13. Remedying the present confusion about the position of long-term care insurance should not have to wait for the evolution of overall long-term care policy. The Panel strongly endorses the recommendation of the Royal Commission that long-term care insurance should be subject to conduct of business regulation by the FSA for the following reasons:

- most purchasers will be financially naïve;
- there will be scope for high pressure selling to a section of the population who are elderly and vulnerable;
- there will be a limited number of products on the market and so most purchasers will be unable to seek alternatives;
- many financial advisers will not have sufficient knowledge of the benefit system to give full advice; and
- many of the products are expensive and complicated.

14. The draft Bill would enable the FSA to extend conduct of business regulation to deposit taking and general insurance if it was justified following a cost benefit analysis. We note that some industry respondents have expressed concern about this. These concerns should already be addressed by changes to strengthen the FSA's accountability. We strongly endorse the retention of the existing flexibility in the Bill to enable the

introduction of conduct of business regulation if at some time in the future the voluntary codes of practice covering banking and general insurance are found to be inadequate or inadequately enforced.

15. We welcome the Government's commitment to consult fully on secondary legislation concerning changes to the FSA's scope, which will also be subject to debate and positive approval in Parliament. However, statutory instruments are far from accessible and transparent. We urge that any consultation explains clearly the provisions of the legislation and its impact on consumers.

16. We are concerned about the interface between the FSA and other regulatory bodies. For example, the respective pension functions of OPRA and the FSA appear increasingly obscure. This will create problems in the context of stakeholder pensions because of the lack of a one-stop shop to deal with consumer complaints (see paragraph 23). There may also be problems in providing clear explanations to the public about the nature of protection and regulation given the split between OPRA and the FSA. We recommend that the pension functions of OPRA and the FSA are subject to urgent review and taken account of in the context of the draft Bill.

Authorisation, enforcement and investigative powers

17. We welcome the powers the Bill will give the FSA over individuals who manage and have a significant influence on the work of authorised firms. We recommend that the Bill gives the FSA powers to check criminal records of such persons as a matter of course to provide appropriate consumer protection. The Bill should also require the FSA to establish a public register of approved persons and of prohibited persons so that consumers can check the status of persons they come into contact with.

18. We strongly support the retention of the range of enforcement powers available to the FSA to provide adequate consumer protection. We note that compliance with the European Convention on Human Rights (ECHR)

has been raised by a number of respondents from the industry. Whilst these concerns must be addressed by the Treasury, they must not undermine the powers of the FSA to protect consumers by effectively enforcing its rules. Whilst we appreciate that disciplinary action cannot be published until the conclusion of disciplinary proceedings, there should be a presumption set out in the Bill that the FSA's use of its powers of intervention will be published to make consumers aware of problems. This is of particular importance in the retail investment market. In our response to the FSA's consultation on the enforcement regime we strongly recommended that the FSA put intervention action into the public domain as a matter of course to raise consumer awareness of problems and because of its deterrent effect.

19. The Government has not yet published the information gateway provisions of the Bill. We recommend that there are information sharing powers to and from the FSA, and OPRA, the OFT, local authority trading standards departments, the Financial Services Ombudsman Scheme and other relevant Ombudsman, amongst others. These will be important sources of information for the FSA's monitoring and enforcement activities. In addition the FSA will be a rich source of intelligence to the OFT in carrying out its competition functions.

20. We recognise the difficulties of extending the information gateway provisions to non-statutory bodies. However, this must be explored as it will be important that information can be shared between the FSA and non-statutory bodies responsible for monitoring compliance with voluntary codes of practice. For example, if the sale of mortgages is not brought within the scope of the Bill the non-statutory bodies responsible for monitoring compliance with the Mortgage Code should be able to receive information that the FSA may have on non-compliance of mortgage lenders and intermediaries with FSA rules.

Single Ombudsman Scheme

21. We welcome the changes to enable the scope of compulsory jurisdiction of the Ombudsman Scheme arrangements to be extended. However, we are concerned that these extensions are at the discretion of the FSA. We recommend that the extensions to scope of the compulsory jurisdiction of the Ombudsman should be set out in primary legislation and not be at the discretion of the FSA or alternatively that the legislation should give the Minister reserve powers to extend the scope of the compulsory jurisdiction.
22. Although the power allowing the Ombudsman to order complainants to pay costs in certain circumstances has been removed, this has been replaced by a power authorising the FSA to make rules authorising the awarding of costs against complainants. We strongly oppose the retention of any power to enable the Scheme to order complainants to pay any costs. This completely undermines the principle of ombudsman schemes which to date have been free to complainants. Experience suggests that many consumers who may appear to be acting unreasonably have valid complaints and they must not be deterred from using the Ombudsman Scheme. As the ombudsman schemes currently have powers to reject claims that are frivolous or vexatious, we do not consider that there is any justification for introducing a power to enable the Ombudsman to recover its costs from consumers.
23. The advantage of a single Ombudsman Scheme will be undermined by the Government's proposals in the stakeholder pensions Green Paper. Under the Government's proposals for stakeholder pensions, complaints will be dealt with by the Pensions Ombudsman and the Financial Services Ombudsman. In its response to the Green Paper the Panel has recommended that customers are offered a one-stop shop for complaints about pensions.

Single compensation scheme

24. We support the creation of a single compensation scheme for consumers.

It will be important to ensure that smooth transitional arrangements are put in place and that the new scheme commences with the new legislation.