

Regulation of Retail Banking Conduct of Business
A review of the first year of the new regulatory
framework
By the Financial Services Consumer Panel

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Introduction

The Financial Services Consumer Panel's role is to advise and, where appropriate, challenge the FSA from the earliest stages of its policy development to ensure that the regulator takes the consumer interest into account. The Panel took a close interest in the FSA's proposals for the future of banking regulation and contributed actively to the debate on the development of the Banking Conduct of Business Sourcebook (BCOBS) and, subsequently, on industry guidance proposed by the former Code Sponsors. The Panel was particularly keen that the principle of Treating Customers Fairly should be applied pragmatically in the retail banking sector and we called for a robust approach to enforcement of the new regulatory regime.

It is now one year since the FSA took responsibility for the regulation of retail banking conduct of business and the Panel considers this an appropriate point at which to review regulatory effectiveness in this area from a consumer perspective.

This report sets out the Panel's views on specific aspects of banking regulation and identifies a constructive set of recommendations for future strategy, policy and practice. In producing it we have drawn on specific projects initiated by the Panel itself as well as regular 'business as usual' discussions with the FSA and other stakeholders.

There is an argument to be made that twelve months is too short a time in which to achieve regulatory change. Up to a point we have some sympathy with that view, but more importantly a year is too long for consumers to wait for fundamentally unfair banking practices to be stamped out.

It is a time of change in the banking sector and in financial services regulation, with strategic debate taking place at national and international level. It is important that high level policy development does not lose touch with basic good consumer outcomes – that is what regulation should deliver.

Adam Phillips
Chair
Financial Services Consumer Panel

3 November 2010

Executive summary

In November 2008 the FSA consulted on proposals for regulating retail banking conduct of business.¹ In that Paper the FSA reported the main findings of its own review of the effectiveness of the self-regulatory arrangements which were then in place, including the Banking Code Standards Board's monitoring and enforcement of the Banking Codes regime as they related to the FSA's deposit-taking remit.

As the FSA reported, there was some support for the Codes from both industry and consumer groups, but it acknowledged concerns about aspects of the Codes' content and the triennial review process. Notably, there was no sufficiently strong overarching fairness objective analogous to FSA Principle 6 on treating customers fairly.

In its response² to the FSA consultation the Panel said that although we found the 'short form' Banking Code informative and helpful we thought that the then current regulatory arrangements for retail banking did not deliver services of the quality that consumers were entitled to expect. Nor did the Panel accept that given the extraordinarily important economic and social role of banking the FSA should continue to have the rather peripheral role it had previously accepted in regulating how banks dealt with their retail customers.

Consequently the Panel welcomed the FSA's decision to regulate retail banking and saw this as a pivotal point for financial services regulation. It is now time to assess whether in this first year the new regime has delivered beneficial outcomes for consumers.

In considering the FSA's effectiveness as the banking regulator we have addressed key questions in what is initially a small number of specific areas. To help us decide on these specific areas we applied a set of objective criteria which included the importance of particular issues to consumers, taking into account information provided by consumer bodies; feasibility, including whether meaningful research in a particular area would be possible; and whether the areas in question fell within the FSAs' regulatory remit, given the split of responsibility between the FSA and the OFT. It is for this reason that our report does not cover the issue of charges for unauthorised overdrafts, an area in which the FSA's involvement was important but not central. This decision does not in any way diminish the importance of the bank charges question for consumers, but is a reflection of the specific focus of this report.

The key questions we have addressed are:

- ⇒ Does the FSA know whether banks have complied with the relevant rules?
- ⇒ Has the FSA undertaken firm-specific supervision and/or thematic work across the sector?

¹ CP08/19** Regulating retail banking conduct of business, available at www.fsa.gov.uk

² Available at www.fs-cp.org.uk

- ⇒ Has the FSA reacted appropriately to the results of its work?
- ⇒ Have the relevant rules and principles achieved their objectives?
- ⇒ What has been the consumer experience in this area?

The areas that we selected for this first review were: the treatment of unauthorised transactions; application of the right of set-off; and interest rate change notification. In addition we have included comments on issues not directly related to retail banking conduct of business requirements, but still of relevance in terms of overall regulatory effectiveness: use of industry guidance; split of regulatory responsibility between the FSA and the Office of Fair Trading; and complaints handling by banks.

While the Panel is pleased with much of the progress that has been made so far in regulating retail banking, and we are mindful of the constraints under which the FSA can act, there are a number of areas where we believe the FSA should have acted more swiftly or more forcefully. There does not seem to have been sufficient emphasis on addressing consumer needs and on customers' overarching entitlement to fair treatment.

We have drawn up a short set of recommendations for the FSA to consider and which we believe will improve consumer outcomes and help to deliver the services which consumers are entitled to expect from their banks. The details are set out in the final section of this report, but the key recommendations are:

- The FSA needs to be more forceful in ensuring senior management buy-in within banks to what is happening at customer level, with more incentive for getting it right – or disincentive for getting it wrong.
- We would like to see the FSA enforcing the principle of Treating Customers Fairly more widely and effectively in retail banking.
- A wider programme of FSA consumer research is required, including mystery shopping.
- The production of more regulatory data through regular returns about unauthorised transactions, including firms' root cause analysis.
- Swifter regulatory action to deal with failings in retail banking conduct of business.
- Consideration of the feasibility of introducing interim or temporary measures to protect consumers during the consultation process.
- Greater supervisory scrutiny of banks' performance at the point of contact with consumers.

Context and history

When the FSA assumed its statutory powers in 2001 it decided to limit its regulatory regime for most deposit-takers – principally banks and building societies – to rule-making in order to: bring into effect EU requirements; address specific consumer issues where needed; and enforce the Principles for Businesses where there were prudential implications. Conduct of business issues continued to be dealt with on a self-regulatory basis by the Banking Code Standards Board (BCSB), which monitored and enforced compliance with voluntary Banking Codes for business and personal customers. The vast majority of, but not all, deposit-takers subscribed to the Code. The Board of the BCSB comprised a Chairman and Chief Executive, four independent directors and three directors representing the Code sponsors. Although the Codes were subject to review, the decision on any changes to the Codes ultimately rested with the Code sponsors³.

Consequently in 2008 banking regulation was effectively split between self-regulation by the BCSB and statutory regulation by the Office of Fair Trading (for credit products) and the FSA (for deposit-taking activities). The FSA then undertook a review of whether this model was the right one for the future, bearing in mind that the FSA was about to become the main competent authority for the Payment Services Directive (which includes conduct of business standards) and that there was “a desire on the part of the regulator to address more comprehensively and effectively prudential and conduct risk affecting the whole of firms’ retail market activities.”⁴

As a result of this review the FSA put forward proposals for a new regulatory framework for retail banking that included:

- ❖ Full application of the Principles for Businesses to FSA regulated activities. This included, importantly, Principle 6 – Treating Customers Fairly.
- ❖ The introduction of rules for retail banking in a Banking Conduct of Business sourcebook (BCOBS).
- ❖ The transfer of existing conduct of business rules applying to deposit-taking to BCOBS.
- ❖ Monitoring and enforcement by the FSA.
- ❖ Payment Services Regulations.

With the exception of the Payment Services Regulations, for which there is a complaints-led regime⁵, this new framework was adopted within the structure of the FSA’s risk-based approach to regulation. The FSA uses its own risk

³ The British Bankers’ Association; Building Societies Association; and the UK Cards Association (formerly APACS)

⁴ FSA consultation paper CP08/19 Regulating retail banking conduct of business at www.fsa.gov.uk

⁵ Some larger banks are likely to have a closer supervisory relationship with the FSA focusing primarily on capital and safeguarding arrangements - PSD Approach document at www.fsa.gov.uk

assessment framework to identify the risks to its statutory objectives and to mitigate them through regulatory action.

Treatment of unauthorised transactions

When money is taken from customers' bank accounts without their permission and/or when the payment instructions are either fraudulent or just wrong, the effects can be devastating for the individual concerned. Some customers who have been the victims of this type of theft or error have found themselves with insufficient funds to meet basic living costs such as rent and food and rely on their banks to refund the money removed from their accounts to do this. No definitive figures are available - due to inconsistent data collection or recording by firms - so it is difficult to quantify the magnitude of the problem across the industry as a whole, but we understand that there could be in the region of 100,000 contacts from customers about unauthorised transactions each month, with about 90% ultimately being refunded by the banks. This lack of comprehensive and comparable data is in itself an issue and one which we address in our recommendations at the end of this report.

The obligations on banks regarding accounts not covered by the Payment Services Regulations, such as savings accounts, are clearly set out in Chapter 5 of the Banking Conduct of Business Sourcebook (BCOBS), specifically:

- 1) Where a banking customer denies having authorised a payment, it is for the firm to prove that the payment was authorised.
- 2) Where a payment from a banking customer's account was not authorised by the banking customer, a firm must, within a reasonable period, refund the amount of the unauthorised payment to the banking customer and, where applicable, restore the banking customer's account to the state it would have been in had the unauthorised payment not taken place.

Without question BCOBS places responsibility for proving that any disputed payment was authorised by the account holder fairly and squarely with the bank, not the customer. Investigations must be undertaken without unreasonable delay. Most importantly, the Payment Services Regulations, which cover payment accounts such as current accounts, require an "immediate" refund of an unauthorised payment, ie on the same day.

Yet the pilot work carried out by the FSA in the early part of 2010 into how firms were handling unauthorised transaction claims from customers raised some concerns for the regulator – and for the Panel. There were failings in some firms in important areas such as customer contractual terms and conditions; internal processes and training material; and quality of management information. We understand that, amongst other things, different firms interpreted the word "immediate" in different ways.

The findings of the pilot project were surprising given that the regulatory requirements were unequivocally clear and that fair treatment of unauthorised transaction claims by customers should have already been a long-standing

feature of banks' processes. The Panel wrote to the FSA in April urging the FSA to take swift action to address the shortcomings that the pilot project had revealed.

Addressing the shortcomings in firms' behaviour in this area became a high profile project for the FSA involving the personal intervention of Dan Waters, the Director of the FSA's Conduct Risk area. Three months after our initial discussions the FSA reported that all major firms had agreed to rectify the non-compliant aspects of their customer terms and conditions and to distribute new terms and conditions without delay. Firms had also agreed to change their internal processes by the end of August 2010 at the latest. Although the FSA did not take up the Panel's suggestion that a "Dear CEO" letter⁶ should be sent to the banks, we understand that a letter was sent instead to compliance officers setting out the FSA's expectations in the treatment of unauthorised transactions. Further substantive testing had been scheduled for the rest of the year.

We understand that delays in securing action by firms were due at least in part to firms' resistance to the FSA's interpretation of "immediate" as being just that. This was an unnecessary waste of time and money that prolonged the detriment being suffered by consumers. Discussions about the Payment Services Regulations lasted over two years before BCOBS was introduced and the FSA produced a comprehensive guide for firms. There was plenty of opportunity for firms to debate and challenge any aspect of the regulations that seemed ambiguous well ahead of the implementation date.

Separately the Panel conducted a limited amount of qualitative research through the Moneysavingexpert website. We are grateful to Moneysavingexpert for allowing us to research consumer experience in this way. There were a total of 69 posts by the beginning of June, although a small number of these related to unauthorised credit card transactions, which are outside the FSA's remit and which we excluded from our project. About half of those who responded reported broadly positive experiences and half broadly negative experiences. There were indications that individual experiences varied widely within the same bank. There seemed to be no real difference in terms of experience as regards the channel of reporting the complaint. Some respondents noted the difficulty in getting an appropriate response in their bank branch. The research confirmed however that for each individual the level of detriment experienced could be quite significant.

Comment

The Panel is still awaiting the outcome of the FSA's further work (probably in January 2011) before being in a position to comment on the overall effectiveness of FSA regulation in this area. Nevertheless we were pleased that the FSA began its pilot work so promptly and that there was such a swift response to its findings, despite apparent push-back from industry. The problem of unauthorised transactions was aired publicly however when Dan

⁶ A letter from the FSA to the Chief Executive of authorised firms used for communicating only the most important/high priority issues. Dear CEO letters are published on the FSA's website

Waters appeared on Radio 4's Moneybox programme. We would have liked to see a published Dear CEO letter used in addition to gain further publicity rather than the unpublished letter to compliance officers which was issued, although we understand that under new FSA procedures such letters will be published in future.

The Panel's albeit limited qualitative consumer research⁷ through Moneysavingexpert suggested a 50/50 split between those who had positive and negative dealings with their banks – and sometimes with the same bank. This suggests to the Panel that the quality of staff training at the point of customer contact is patchy and that banks need to focus more attention on the delivery of a fair and compliant service to their customers at the point of customer contact. This is an area in which we would like the FSA to monitor progress.

⁷ Which could have included instances that occurred before the FSA's regime was put into place

Application of the right of set-off

Set-off is the process by which banks exercise their right to take money from a customer's account which has a credit balance and use it to repay a debt in the same customer's name, such as overdue instalments on a loan. It could be described as combining two accounts in the same name, one in credit and one in debt.

The application of set-off can have a devastating effect on individual consumers particularly when, for example, money is taken quite wrongly from joint accounts or accounts used for direct payments for care, or those where a power of attorney is in place. Nor is it always clear to customers that banks have the right to remove money from their accounts in this way if they so wish. The consequence in many cases has been that consumers are left with no money to meet basic living costs and existing commitments, such as rent and direct debit payments for fuel and water. For customers already in financial difficulty this can only escalate their problems.

It is not clear how many customers are affected by set-off, although the Cost Benefit Analysis undertaken by the FSA refers to around 2mn set-off transactions of between £100 and £200 per transaction per year. But it is the impact on individuals rather than the collective picture that particularly concerned the Panel.

The regulation of banks' use of set-off falls in part to the FSA (on the deposit-taking and Principles for Business side) and in part to the Office of Fair Trading (consumer credit) with the Lending Standards Board⁸ having a role in developing standards and providing guidance for its subscribers on the application of set-off. The previous Banking Code had contained no specific commitments on the use of set-off, although there was some guidance for firms on the classification of priority payments.

The FSA was aware in 2009 that various bodies, including the Panel, had raised concerns about set-off. In the March/April 2010 edition of Ombudsman News⁹ it was reported that the nature of complaints about set-off was changing in that they now seemed to relate more to whether the bank had acted fairly in the way it had used set-off than, say, differences in ownership of the accounts that had been combined. What was clear was that set-off was still being used inappropriately by some banks.

In response to those continuing concerns a revised Moneymadeclear guide was issued to provide help and information for consumers and the FSA continued to debate the question with the Panel, consumer bodies and industry. This process took some months. It is possible that the division of regulatory responsibility between the FSA and the OFT may have contributed

⁸ The Lending Standards Board is the successor organisation to the Banking Code Standards Board and its key objectives include assisting firms to interpret the Lending Code and to monitor and enforce compliance with the Code

⁹ Issue 84, at www.financial-ombudsman.org.uk

to the delay, but we understand that the main reason was the time taken to research and consult.

The FSA identified the key issues as many customers simply being unaware of the right of set-off; customers not engaging with their banks when they miss payments; banks not taking into account individual circumstances when calculating set-off amounts; customers not being given appropriate notification by their bank when it has used set-off; and banks lacking consistency when dealing with customer queries relating to set off.

Having completed its liaison with key stakeholders, the FSA decided to produce guidance tackling these areas, to be added to BCOBS. The consultation paper¹⁰, which specifically acknowledges concerns raised by Citizens Advice Bureaux and Money Advice Trust, among others, was issued in July 2010 with a deadline for responses of 6 September. The Panel strongly supported the FSA's proposals, but we urged the FSA to monitor firms' use of set-off closely, including conducting detailed file reviews, and to be ready to use enforcement action. We also believe that if the guidance does not deliver the right outcomes for consumers within the first few months, the FSA should reconsider the introduction of prescriptive rules to address the consumer detriment.

The Panel has not itself commissioned any research into the effect on consumers of the application of set-off, relying instead on work already undertaken by other consumer representatives and the knowledge of individual Panel members, as well as information provided by the FSA.

Comment

The Panel was pleased that the FSA responded to concerns expressed by consumer bodies about the application of set-off and that there was fairly extensive liaison with stakeholders before the July consultation paper was issued. Nevertheless there is a balance to be struck between balanced and extensive consultation and the needs of individual consumers suffering real detriment every day. So while we do not criticise the FSA for taking steps to ensure that it had canvassed views and understood the issues, we would have liked to see rules or guidance in BCOBS much sooner. At the time of writing this report, one year on from the initial discussions about the use of set-off, the new guidance is not yet in place.

Currently regulatory responsibility for the use of set-off is effectively split between the FSA and the OFT. We have commented on this regulatory split later in the report, but in the context of the use of set-off in particular we are unclear as to the applicability of the Principle of Treating Customers Fairly, which we understand from the FSA Handbook¹¹ can only relate to the provisions of the Financial Services & Markets Act.

¹⁰ CP10/15 Quarterly CP, at www.fsa.gov.uk

¹¹ At www.fsa.gov.uk. The Principles for Businesses apply to regulated activities, being activities specified in Part II of the Regulated Activities Order, under section 22 of the Financial Services & Markets Act 2000 and do not apply directly to unregulated business

We have already urged the FSA to monitor closely firms' compliance with the new guidance and to be ready to take action if the guidance fails to meet objectives. It will be some months yet, we believe, before the overall effectiveness of this particular aspect of BCOBS can be assessed. Monitoring will have to include individual file inspections and consumer research if it is to take account of individual consumer experience and the work would also have to involve the OFT and the Lending Standards Board, due to the division of regulatory responsibility.

Interest rate change notification

Consumers need to make decisions from time to time about the products and services that are being provided by their banks. These decisions include whether to switch, add to or withdraw monies from deposit accounts. Consequently it is important that banks advise their customers of, amongst other things, any material adverse change to savings interest rates, especially where these are to their disadvantage. In the current climate of low interest rates, notification of the end of bonus rates is particularly important. Customers who are unaware of rate changes can find themselves with an account that pays little interest when there may other accounts – even with the same bank – that will provide a better return. There are a number of helpful sites available on-line, such as the [Moneymadeclear](http://www.moneymadeclear.org.uk)¹² comparative table on savings accounts, but these are not accessible to everyone and, in any event, it would be notification of a rate change that would be most likely to prompt savers to review their accounts.

In March 2010 Consumer Focus made a super-complaint to the OFT on the subject of cash ISAs, including issues around keeping customers informed of interest rates and transferring accounts. In its discussions with the OFT the Panel endorsed the generality of Consumer Focus' approach and emphasised the need for consumers to have up-front information about the rates offered on all a bank's savings accounts – not just the latest offering – in order to make an informed decision about switching. In June the OFT responded with a number of proposals for improvement, based on agreements that had been negotiated with industry. We will expect the FSA to step in with prescriptive regulatory action if industry fails to live up to these commitments.

When the FSA issued its policy statement on regulating retail banking conduct of business in April 2009¹³ it announced that there would be further consultation on new guidance on its "appropriate information" rules in BCOBS to require firms to provide advance notice of changes to interest rates that are to a customer's disadvantage. This consultation paper was published in July 2009¹⁴.

The Panel supported FSA's proposals – the guidance is comprehensive and makes sense for consumers who are trying to manage their money effectively - but we were opposed to plans to allow a transitional period which meant that the guidance would not be brought into effect until 1 May 2010. In the meantime firms would continue to comply with the general law and the current Banking Code (if the bank was a subscriber), although the Principle of Treating Customers Fairly had applied from November 2009.

The Banking Code's provisions on interest rate change notifications were far less helpful than BCOBS, as supported by the guidance:

"Banking Code:

¹² www.moneymadeclear.org.uk

¹³ Policy Statement 09/06 at www.fsa.gov.uk

¹⁴ CP09/20 Quarterly consultation no 21 at www.fsa.gov.uk

Changes in interest rates

4.4 We will keep you informed about changes to the interest rates on your accounts and we will tell you about the ways we will do this.

4.5 When we change the interest rates on your accounts, we will update the information on our phone helpline and our website within three working days. To help you compare rates, the old rate will also be available on our website and our helpline.”

During the transitional period to 1 May 2010 the BBA prepared draft industry guidance¹⁵ on advance notification of disadvantageous interest rate changes. This contained a number of detailed proposals addressing issues such as what constitutes a material change in interest rates individually and cumulatively, and reasonable notice periods. Following discussions with the BBA, the Panel was able to give its support to the BBA’s proposal. The BBA had provided evidence that the Panel’s preferred approach – which included all account holders being advised of adverse changes in interest rates, however low the account balance – would be excessively costly for consumers.

Comment

Given that the new guidance only came into effect on 1 May 2010 the Panel has not yet undertaken any research into customers’ experiences of the new arrangements. This is a question we will be considering further. Nevertheless we are pleased that the FSA recognised the importance to consumers of being kept informed of any material reduction in the amount of interest payable on savings accounts, including the end of bonus rates, although it would have been helpful to consumers for the guidance to have been in place much earlier.

¹⁵ We have commented on the industry guidance process later in this report

Other issues

There are a number of other issues not directly, or solely, related to BCOBS but which nevertheless are relevant to the overall question of the effectiveness of the FSA's regulation of retail banking conduct of business. We have dealt with these in this section of the report.

Use of industry guidance

Procedures¹⁶ have been in place since 2007 for applications to be made to the FSA for guidance on FSA rules and principles prepared by other bodies such as trade associations, to be "confirmed". The significance of confirmation is that it recognises that particular pieces of guidance prepared by the industry set out one way in which a firm can comply with specific FSA rules and principles. Compliance with confirmed industry guidance therefore provides evidence of a firm's compliance with the underlying rule to which it relates. Any firm or trade body drafting industry guidance that will directly affect consumers must consider consumer interests and views before presenting the draft to the FSA. The Consumer Panel has a specific role to perform in the confirmation process. All confirmed industry guidance is published on the FSA's website.

The former Code sponsors through the BBA first produced industry guidance on BCOBS in 2009. The Panel and other consumer groups had serious concerns about the consultation process that the sponsors had adopted and we asked the FSA not to confirm the draft guidance at that point. In fact while the FSA was prepared to confirm, it did so for a period of one year only. That guidance is currently being reviewed by the sponsors ahead of the expiry of the FSA's confirmation.

The Panel had three initial concerns about the draft guidance. These were the draft provisions relating to set-off (dealt with earlier in this report) and basic bank accounts; and the consultation process. This was ill-timed, did not allow consumer bodies adequate time to respond and ultimately there was little evidence that comments from consumer groups were given appropriate consideration. While some progress has been made on both set-off and basic accounts, we are awaiting the outcome of the current review process before assessing whether it meets the standards we consider necessary for industry guidance that has a direct impact on consumers.

Despite the FSA's strategic move away from principles-based regulation to outcomes focused regulation we understand that the confirmation process for industry guidance is to remain. The Panel has long supported moves by industry to raise levels of compliance and to develop 'best practice' in certain areas. So although we are pleased that the industry has invested so much time and trouble in producing industry guidance, we will be continuing to monitor the industry guidance process for BCOBS to see if it is ultimately delivering real benefits for consumers, or whether we should press the FSA to

¹⁶ Information about the FSA's policy (Policy Statement 07/16), confirmation criteria and process for granting confirmation are available at www.fsa.gov.uk

produce its own guidance – or if necessary prescriptive rules - which will be subject to full and open consultation, where circumstances demand.

Split of regulatory responsibility between FSA and OFT

As explained earlier in this report, regulatory responsibility for retail banking is split between the FSA for deposit-taking, conduct of business and the Payment Services Regulations and the OFT for consumer credit issues. Inevitably, there is overlap.

The question of whether in the new regulatory structure the proposed Consumer Protection and Markets Authority should have responsibility for all the credit activities of firms that they authorise and regulate or indeed all consumer credit, is not one for this report. The Panel has responded separately to the recent HM Treasury consultation on financial regulation¹⁷ and has submitted evidence to the Treasury Committee inquiry into financial regulation that covers this and many other regulatory issues.

Regulatory links/overlap between the FSA and OFT are not new – the two bodies published their first action plan for delivering better regulatory outcomes¹⁸ in 2006 – and on 1 November 2009 a new concordat was agreed between the regulators setting out where responsibility for various parts of BCOBS and the Payment Services Regulation lies. But it is still not clear how effectively regulatory issues are dealt with on a day to day basis.

The question of set-off and how its misuse is being tackled is an example of the lack of clarity that can arise. For example, does the Principle of Treating Customers Fairly apply to the entire set-off process, or only the part that relates to accounts in credit? How would that work in terms of enforcement? This is a particular concern in an area of banking practice like set-off where true “fair treatment” is of paramount importance.

Complaints handling by banks

In April 2010 the FSA published a report¹⁹ on thematic work it had undertaken into how banks handle customer complaints. The review covered several banking groups responsible for over 70% of the complaints firms report to the FSA and over 60% of those resolved by the Financial Ombudsman.

The FSA found poor standards of complaint handling within “most” of the banks reviewed, including a lack of senior management engagement and accountability for the delivery of fair complaint handling; and in some cases poorly designed staff incentive schemes that made branch staff reluctant to pay redress to customers, even in situations where the bank was at fault. In addition, the FSA found that banks had failed to learn from previous complaints and failed to make changes to prevent similar complaints arising in the future – very basic good business practice.

¹⁷ A new approach to financial regulation: judgement, focus and stability at www.hm-treasury.gov.uk

¹⁸ At www.fsa.gov.uk

¹⁹ At www.fsa.gov.uk

As a result of the thematic work the FSA published a complaints handling file review template to help firms assess if their complaint handling is achieving fair outcomes for customers. We support the development of this simple and pragmatic tool to help banks to deal with complaints in an appropriate way. The FSA also reviewed whether changes should be made to the complaints handling rules.

The complaints handling rules were not new requirements contained in BCOBS – banks were well aware of and ostensibly working to comply with the rules for a number of years. Consequently we found banks' performance unacceptably poor. The deficiencies covered a number of broad areas such as corporate governance and culture that impacted way beyond the systems and controls in place to handle complaints. All in all, none of those banks found wanting in the FSA's work could in our view be said to have treated their customers fairly.

We have welcomed moves by the FSA and Financial Ombudsman to ensure that complaints data is published – although it is a pity that the FSA had to overcome resistance from the banks before it did so - and we have been pleased to see the open discussion that publication has stimulated. The entire exercise could be a far more powerful regulatory tool for everyone however, including the banks themselves, if the complaints data was placed clearly in context.

We have been told that there is evidence to suggest that banks are taking steps to minimise the number of complaints that they report to the FSA by manipulating the reporting requirements, rather than by resolving complaints. Particular examples that have been quoted to us are of firms claiming that complaints have been resolved within 24 hours when in fact they have not; and firms refusing to record complaints as complaints. Consequently there is a risk that the published data does not reflect the true position. This is an area that we have raised with the FSA through our regular liaison work on emerging consumer risks.

The Panel is a strong supporter of the use of transparency as a regulatory tool. We would like to see the FSA taking swift and tough action in the public arena in cases of non-compliance. We have been advised that the FSA is now working with external stakeholders to improve complaints handling standards. No bank should be under any illusion now about the need to handle customer complaints fairly and in compliance with the rules. In an interview on Radio 4's "You and Yours" on 9 September 2010 Dan Waters explained that the FSA's supervisory work on improving banks' complaints handling was a priority and that the FSA would make sure that change is delivered. We are looking forward to seeing greatly improved consumer outcomes as a result.

Conclusions and recommendations

In this section of the Report we have considered the five questions we identified earlier in the context of each of the three specific areas we decided to cover in our review. From there we have drawn up a short set of recommendations for the regulator which we believe would help to deliver better consumer outcomes in retail banking.

Conclusions

- | |
|---|
| 1. Does the FSA know whether banks have complied with the relevant rules? |
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Treatment of unauthorised transactions

The Panel has been advised that there is no definitive data available about the number of unauthorised transactions reported, the amounts involved and the root cause of the problem – for example, to what extent unauthorised payments were instigated from outside the bank concerned and how many from within. Similarly it does not seem to be possible to assess the extent of losses resulting from unauthorised transactions across the sector as a whole. The absence of data is in itself a concern as it is not possible to assess the impact of unauthorised transactions on consumers, which would inform the FSA's regulatory approach to the problem. It appears therefore reasonable to conclude that the FSA will need to do further work, including collecting data on this issue, before it is in a position to know whether compliance has been achieved.

Nevertheless the FSA included unauthorised transactions within the scope of the pilot work it conducted in early 2010 in the course of which a number of significant failings by some firms were identified.

Application of the right of set-off

The FSA was aware in 2009 of the numerous concerns that had been raised by consumer groups about banks' application of the right of set-off. Further information was available through complaints data published by the Financial Ombudsman Service.

Interest rate change notification

The FSA acknowledged in 2009 that there was a need for guidance on requirements relating to changes to savings interest rates and committed to consulting further on this point. The FSA would also have been aware of the Consumer Focus super-complaint on cash ISAs, which included issues relating to keeping customers informed of interest rate changes. It is disappointing that despite the existence of FSA guidance it took a super-complaint to achieve action by firms – albeit not until 2011/12 - rather than active enforcement of compliance with FSA requirements.

2. Has the FSA undertaken firm-specific supervision and/or thematic work across the sector?

Treatment of unauthorised transactions

The FSA has undertaken (pilot) thematic work and following that, has worked with individual institutions to make the necessary changes to their processes and relevant terms and conditions of customer agreements. The FSA is also carrying out further testing.

Application of the right of set-off

We are not aware of any thematic work being undertaken across the sector, but the FSA has been responding to information provided by consumer bodies.

Interest rate change notification

We are not aware of any thematic work being undertaken since the FSA's/BBA's guidance was introduced, although future work might cover notification of the end of bonus rates.

3. Has the FSA reacted appropriately to the results of its work?

Treatment of unauthorised transactions

Within three months of the Panel's initial discussions with the FSA, the FSA reported to the Panel that all major firms had agreed to rectify the non-compliant aspects of the customer terms and conditions and to distribute new terms and conditions without delay. There was also agreement for firms to change their internal processes by the end of August 2010. Further substantive testing will be taking place throughout the year.

The FSA also commented in the media on the issue and written to compliance officers – although the letter has not been published.

Application of the right of set-off

Given that the consultation exercise on new guidance for BCOBS closed on 6 September and no policy decision has yet been taken, it will be difficult to comment on the appropriateness of the FSA's response to the issues. Nevertheless the FSA's decision to consult with stakeholders ahead of consultation seems appropriate, but this resulted in delay.

Interest rate change notification

While we are not in a position to comment on the effectiveness of the guidance as we have no research data on this issue, we think that the FSA should not have allowed a transitional period for firms during which time the less helpful Banking Code requirements applied. Firms had ample time

during the consultation period to raise concerns over their ability to comply with BCOBS and we saw no real justification for delay.

4. Have the relevant rules and principles achieved their objectives?

Treatment of unauthorised transactions

It will not be possible to take a view on this question until after the FSA's further testing has been completed.

Application of the right of set-off

As the new requirements are not yet in place it will not be possible to determine whether objectives have been achieved until 2011.

Interest rate change notification

Again, it will not be possible to reach a view on this until later in 2011.

5. What has been the consumer experience in this area?

Treatment of unauthorised transactions

The Panel's limited qualitative research showed a divergence of experience not only between different banks, but within the same bank. It was also evident that for some individuals there had been significant financial detriment.

Application of the right of set-off

Historically there has been a wealth of evidence from consumer bodies that the right of set-off has been applied inappropriately in the past and we understand that there might be more recent evidence available that this is continuing.

Interest rate change notification

The information available to us is historic. Further work would have to be carried out before we could assess the consumer experience under the new 'regime'.

Recommendations

Our detailed comments are set out below. Overall our view is that while we are pleased with what the FSA has achieved so far, from a consumer perspective there is disappointment that this progress has been slow in some areas. We are conscious that there have been a number of regulatory barriers that the FSA has had to address, such as the split of regulatory responsibility with the OFT and the absence of specific powers to require the publication of complaints data. Nevertheless on issues such as the use of set-off and ISA interest rate change notifications there was a need for urgent

action that simply did not happen – the timetable for change has been just too long.

We would also like the FSA to be more forceful in ensuring senior management buy-in within banks to what is happening at customer level, such as how unauthorised transactions are being dealt with by branches, with more incentive for getting it right – or disincentive for getting it wrong. In this respect we were interested to see the recent speech²⁰ by Hector Sants at the Mansion House Conference on Values and Trust in which he raised issues around culture within firms and senior management judgement.

Finally, as we said in our response to the FSA's original consultation paper, we would like the FSA to go further in applying the principle of Treating Customers Fairly to retail banking. In all the specific areas we have focused on in this report TCF should have applied from the outset on a common sense basis.

We look forward to following up the findings and recommendations of this report with the FSA, particularly during the transitional period leading up to the establishment of the new regulatory regime and transfer of responsibilities to the Consumer Protection and Markets Authority and Prudential Regulatory Authority.

Consumer research: the Panel is fully supportive of the FSA's programme of thematic work and its regulatory focus on outcomes rather than processes. But we remain concerned that despite the FSA's fairly high profile approach to aspects of BCOBS such as unauthorised transactions, there is still evidence of inconsistencies within firms and areas of non-compliance. We would like to see the FSA undertaking consumer research so that it is more informed about how banks are performing at branch/contact centre level, most importantly including a programme of mystery shopping. Mystery shopping is the only way in which the regulator can really learn about and understand the consumer experience. As our report has shown, there seems to be a lack of senior management buy-in within banks to what is happening at customer level. Appropriate policies and procedures may be in place, but delivery is inconsistent. We would be pleased to discuss with the FSA areas which could usefully be investigated in this way.

Complaints data: the Panel supports transparency as an effective regulatory tool and we are pleased that complaints data is now being published. There is still a need however for the FSA to investigate the accuracy of firms' reporting – as we have said in this report, we are aware of evidence collected by others to suggest that some firms are manipulating the reporting process to minimise the number of complaints recorded, or are not recording complaints at all – and to provide data in an appropriate context. This is an opportunity for both consumers and banks to use complaints data publishing constructively. Ideally we would like the FSA or its successor bodies to require publication of complaints data within a structure set down by the regulator.

²⁰ "Can culture be regulated?" 4 October 2010 at www.fsa.gov.uk

Other data: we were a little surprised that there seemed to be so little data available about unauthorised transactions in terms of volume, amount and root cause. We think this is an area on which banks should be able to report on a consistent basis with little additional cost as we would expect them to have this available in the form of management information for in-house use.

Timing: there is a balance to be struck between the need for regulatory action based on stakeholder consultation and the need for urgent action to protect consumers from unfair practice. This is a matter of judgement and can be difficult. Nevertheless there have been occasions where we would have liked to have seen the FSA acting more swiftly and decisively to deal with areas of consumer detriment in banking. Banks' use of the right of set-off is an example. Individuals have suffered real hardship as a result of the inappropriate use of set-off and we are concerned that it has taken almost a year for guidance to be put in place to address the problem and that this is just too long. We would like to see the FSA being more responsive to issues as they arise. In particular, we would encourage the FSA to consider the feasibility of introducing interim or temporary measures to protect consumers while conducting the consultation process. Perhaps the FSA's new practice of dealing with non-Handbook guidance could be used to address this issue.

Supervision: the FSA is committed to a programme of more intrusive supervision and we have already referred to the need for more extensive use of consumer research. In our view the nature of retail banking is such that in addition to the need for the FSA to review a bank's policies and procedures at a high-level and/or strategic level, it will be necessary for supervisors to scrutinise individual files in order to understand fully where banks are failing or succeeding to meet consumer needs. We would also like the FSA to monitor banks' performance at the point of contact with the consumer. As we have indicated, this could be achieved through the use of mystery shopping. As regards complaints handling by firms, we were pleased to note that Sheila Nicoll, Director of Conduct Policy at the FSA, has described complaints handling as "a priority area within the FSA's intensive supervision agenda."²¹ We look forward to seeing the outcome of this work.

²¹ Press Notice 11 March 2010 on publication of DP10/1 Consumer Complaints (Emerging risks and mass claims) at www.fsa.gov.uk