



Financial Conduct Authority  
FCA Head Office  
25 The North Colonnade  
London  
E14 5HS

23<sup>rd</sup> January 2017

Dear Sirs,

**Re: Response to Consultation on the Future Mission of the FCA**

We are responding to the document published by the FCA entitled "Our Future Mission". The UK Shareholders' Association (UKSA) represents the interests of private shareholders who hold shares directly or indirectly (via nominee accounts) in public companies as well as those holding other kinds of equity-based investments. We therefore have a strong interest in the issues raised in the FCA's Mission Statement.

Our answers to the specific questions in the Mission Statement are attached to this covering letter. We have also posted them on the on-line response form.

When drafting our response to the questions it became clear that there were a number of key underlying 'themes'. We have drawn these together and they are summarised below.

1. **Focus of responsibility:** ultimately, consumers should be responsible for their own decisions and actions; the principle of 'caveat emptor' should always apply. A key role of the regulator should be to create, as far as possible, an environment in which consumers can reasonably be expected to take responsibility. The main requirements for this to happen are discussed in a number of the points below.
2. **Consumer education:** more needs to be done to ensure that consumers buying financial products and services have a basic level of financial awareness. This is essentially a government-policy issue as financial literacy needs to start at school. Sadly, basic levels of numeracy remain depressingly low let alone levels of financial awareness among many consumers. In an age when anyone over the age of sixteen is encouraged to have a credit card and most young people heading for university view taking on a large student loan as the norm it is unacceptable that financial awareness is not part of the national curriculum.

3. **Transparency and saver / investor information:** most intermediaries and advisors in the financial services sector present themselves as being impartial and ‘there to help’. They are anything but this. They are invariably selling. The literature, the information and the advice that they give are directed towards encouraging consumers to buy their products and services. The information presented is usually selective and suppresses important information that might make the consumer think twice about buying. The way in which fees and other charges associated with personal pensions are presented is a good example. Much more should be done to define what constitutes good practice in this area, praise those who are exemplars of good practice and name and shame those who adopt poor practice.
4. **Vulnerable consumers:** all consumers are potentially vulnerable. However, having addressed the two points above, regulation should focus on managing and providing redress in situations in which consumers took every precaution to protect themselves but still suffered significant financial loss. Examples include the failure of Equitable Life and the failure of Farepak, the Christmas savings scheme. These two examples are pertinent and instructive because most of the Equitable Life policyholders who lost money were able, well-educated people. However, they could not possibly have foreseen the disaster that would decimate their pension savings when the company got into trouble - partly due to an overt failure of regulatory oversight. Farepak attracted very different customers – people who would perhaps be seen as ‘vulnerable’ in a more traditional sense. They lost less money but, for them, it was still a financial disaster. Both groups consisted of responsible and prudent people making regular savings to meet future needs; they deserved better protection. Both groups were badly failed by the system of financial regulation.
5. **Regulatory philosophy:** from the above it will be clear that our preference is for regulation which is proactive and seeks to head off problems before they arrive. There is still too much emphasis on shutting the stable door after the horse has bolted. This is unhelpful and unsustainable. The Financial Ombudsman Service appears to be overwhelmed by disputes between consumers and service providers. The system of redress for PPI miss-selling appears to have taken on a life of its own. There can be very few people who have not been cold-called by a claims-handler promising to get them a refund without even knowing whether they ever had PPI insurance. In this particular case the system of redress risks becoming an incitement for fraud. Again, this sort of approach, which attempts to put things right after they have gone wrong, is not sustainable.
6. **Regulators’ relationships with the industry they regulate:** much more thought needs to be given to this issue. Following the financial crash of 2008/9 we were told how much had been learnt by all involved in regulating, monitoring and managing

the financial services industry. This did not prevent the near failure of the Cooperative Bank in 2013 in which bondholders lost significant amounts of money. The regulator in the meantime was all ready to wave through the acquisition of TSB by the Co-op Bank. The evidence given by Clive Adamson at the Treasury Select Committee in response to the Coop Bank crisis suggested a regulatory culture which remained cosy, complacent and at times arrogant.

We are pleased that the FCA has published its Mission Statement and invited feedback. We believe that this is a valuable exercise, not least because it encourages those who are affected by financial regulation to think carefully about what they want from regulation, how well it works for them and how they believe it could be improved and developed.

Our responses to the specific questions set out in the Mission Statement are given below. We would be pleased to discuss these and the summary above in more detail with the FCA if this would be helpful.

Yours sincerely,

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## **FCA Mission Statement (MS) – Comment and feedback**

### **Ensuring markets function well**

**Q1: Do you think our definition of a well-functioning market is complete? What other characteristics do you think we should consider?**

We cannot see a definition in the document of a 'well-functioning market'. There are a number of observations about some of the characteristics of well-functioning markets but no specific definition of what the FCA believes this means. The MS talks about the theory of well-functioning markets and then goes on to say that 'in the real world markets do not always function efficiently'. This reinforces the view that the definition of a well-functioning market 'in the real world' (i.e. the one that will be of interest to most people) is not stated.

**Q2: Do you think our approach to consumer loss in well functioning markets is appropriate?**

No. The MS fails to address the problem of obfuscation by suppliers which leads, for example, to:

- deliberate attempts by suppliers to confuse customers making it difficult for the customer to compare different services and their prices and benefits from the same supplier let alone compare them with those of other suppliers.
- The practice of adding hidden costs and / or the use of pricing structures that are opaque and in which it is impossible for the customer to tell what has been included in the price or how the price has been calculated.

The MS also fails to explore the meaning of ‘consumer loss’ (although there are some references to this elsewhere – Section 10). If a consumer buys an investment product and it fails and the consumer loses their money they suffer financial loss. This is easy to understand. However, if a consumer buys an insurance product, the way in which loss materialises may be much less clear. If their choice of ‘product’ is based on lowest price they may find when they make a claim that there are significant limitations in terms of what they are covered for. What is the loss that they suffer? Is it one of having to foot the bill for the things that were not covered? Maybe... However, what if the cheaper option, overall, offered better value for money? Have they still suffered a loss? What if they bought a product that was over-specified for their needs or which covered their needs but represented poor value for money. What loss have they suffered then?

What about the situation in which people are encouraged to buy things they don’t need at high prices such as extended warranty insurance? This is similar to the scandal of PPI insurance and it is still widespread in many consumer goods markets.

**Q3: Do you think we have got the balance right between individual consumer due diligence and the regulator’s role in enforcing market discipline?**

Again, the MS makes a number of observations (for example, about the fact that a world in which there are no bad outcomes is not achievable) but it does not say what the FCA thinks the balance should be between consumer due diligence and enforcement of market discipline. In reality, it will vary. The MS alludes to this when it talks about focusing on things which have most potential to cause damage to the economy (or perhaps the consumer). However, a more specific articulation of what the FCA understands by the ‘right balance’ is needed. Loss of pension savings can be as disastrous to a relatively well-off consumer as the failure of a Christmas savings scheme is to a consumer with few savings or assets. Many savers with Equitable Life suffered life-changing losses when the pension provider collapsed. They had much more trouble obtaining redress than those who suffered much lower losses as a result of PPI miss-selling which has been pursued with a vengeance by regulators. Furthermore, PPI miss-selling, although widespread, did not result in major financial loss for most consumers on a case by case basis.

**Q4: Do you think the distinction we make between wholesale and retail markets is right? If not, can you tell us why and what other factors you believe we should consider?**

The distinction is superficially appealing. However, it does not stand close scrutiny. The term ‘wholesale’ appears to be used as a short-hand description for business-to-business markets. However, banks make overdraft facilities available to private individuals, small businesses and large businesses. The principles underpinning this type of banking business are the same in each case. In some cases individuals may consistently run larger overdrafts than small businesses. It is not clear therefore what the true distinction is between wholesale and retail markets in this respect. The same could be said to be true of many areas of, say, property insurance.

It is not true to say that third party advice is widespread in retail markets and, by implication, that it is not widespread in 'wholesale' markets. There are many areas in retail markets in which a third party acts as nothing more than an intermediary. Insurance brokers often act in this way as do many ISA providers. Private client stock brokers will also act on an execution-only basis if that is what the client wants, although many find it more profitable to offer only advisory or discretionary services. In the business-to-business field there is plenty of advice on offer but it tends to be of a specialist nature provided by M&A experts, investment banks, lawyers and specialist consultants.

It is true that contract law tends to offer greater protection to retail customers or consumers than it does to businesses as customers. The consumer has tended to be seen as a weak vessel who is incapable of understanding the finer points of a contract into which they may be entering and who is not in a position to renegotiate the contract terms with the provider before signing up. Business, in contrast, are seen as being big enough to check contract terms for themselves and to pay for the relevant expert advice to ensure that they are not being treated unfairly. However, as we have seen, many small businesses struggle to pay for expert legal advice, are often put in a take-it-or-leave-it position by (for example) banks. We have seen how small businesses have been forced to buy complex, expensive and risky products such as interest rate protection products (interest rate swaps) when taking out a bank loan. For the FCA to suggest that, because this is a business-to-business transaction, it is somehow part of a different market and justifies less protection shows a concerning lack of insight. The thinking is both illogical and unhelpful.

The FCA has not asked about capital markets. We have not therefore commented on the many injustices that exist between retail investors and 'industry insiders' in capital markets. However, they are not difficult to find; they include exclusions from fund raisings and the fact that retail investors, who are increasingly forced to invest in shares and other securities through nominee accounts, enjoy none of the rights normally associated with share ownership – such as the right to attend company AGMs and vote.

In short, much more consideration and analysis is needed in the debate about market segmentation. It is an area which is fundamental in defining the FCA's business mission.

**Q5: Do you think the way we measure performance is meaningful? What other criteria do you think are central to measuring our effectiveness?**

No, because the MS has not said how the FCA is going to measure performance. It contains a number of broad statements about the main areas in which the FCA intends to measure performance but does not provide:

- Examples of what the FCA is going to measure
- A clear statement of why these metrics are important as measures of success
- An indication of the ease and practicality of gathering the information to monitor the FCA's success and effectiveness.

Too much regulatory effort in the past has revolved around little more than remorseful hand-wringing and reactive forms of redress after things have gone wrong. Far too little effort has gone into stopping them going wrong in the first place and heading off disasters before they happen. There is nothing here that tells me how the FCA plans to adopt a more pre-emptive approach in

future and what it will measure to assess success. There is a little more information later on (e.g. in Section 12) but not here.

## Meeting our objectives

### **Q6: Do you think our intervention framework is the correct one?**

It is hard to tell because parts of the framework are unclear. The first two steps in the intervention framework are clear enough. However, the last two steps lack clarity of meaning. What is meant by 'Identification of tool'? There are some statements below the relevant box in the diagram, but what do these statements mean? What is 'Entry and Exit'? Further on in the text there is reference to six diagnostic tools. However, these do not seem to be the tools referred to in the third box along the line in the diagram. Nor do they seem to align with the diagnostic approaches mentioned below the second box in the diagram (Common diagnosis of cause..).

The last box in the diagram is also unclear (FCA intervention). The implication in the diagram is that the outcome of this is just to publish an analysis of the findings from any investigation by the FCA. However, this can't surely be the end of the process. There must be scope for whatever remedial action the FCA considers appropriate. The preamble to the presentation of the framework seems to make this clear. So why the apparent confusing disparity between the preamble and narrative and what the model itself appears to say?

### **Q7: Do you think the way we interpret our objective to protect and enhance the integrity of the UK financial system is appropriate? Are there other aspects you think we should include**

The so-called second objective (Protect and enhance the integrity of the UK financial system) is an aspiration. It is unquantified and does not constitute a meaningful and measurable objective. Too much of what follows is hedged around with caveats about the limitations of the FCA's powers and authority, best use of the FCA's resources and avoiding outcomes with unintended consequences. There is interesting comment on the principles of good regulation and about types of harm and how the FCA defines harm. However, little of this provides significant enlightenment on whether the FCA is appropriately interpreting its objective of protecting and enhancing the integrity of the UK financial system.

## Regulation and broader public policy – getting the balance right

### **Q8: Where do you believe the boundary between broader policy and the FCA's regulatory responsibility lies?**

See response to Q10 below. It is the responsibility of government to set policy. One would expect this to include policies which ensure that:

- People are not excluded from obtaining essential financial services such as home insurance because, for example, they live in an area that is prone to flooding.
- People make appropriate financial provision for themselves in later-life; this includes not only pension provision but making adequate financial provision for care in old-age.
- Everybody receives basic education in financial awareness; current levels of financial awareness are generally very poor amongst many people. Even more deplorable are basic levels of numeracy.

Once policy has been set by government it should then be the responsibility of the regulator to regulate consumer financial markets. Clearly, the policy set by the government (or the lack of policy or the failure of the policy) will have a major impact on the degree of regulation and consumer protection that is needed. In a country in which many people lack even the most basic numeracy skills (e.g. the ability to do simple percentages in their heads) then high levels of regulation and consumer protection are going to be needed if people are to be protected from making simple mistakes when buying complex financial products. This is not a satisfactory state of affairs. It is far better to have well informed and sophisticated buyers and less draconian and intrusive regulation. That should be the goal of government and regulators.

**Q9: Is our understanding of the benefits and risks of price discrimination and cross subsidy correct? Is our approach to intervention the right one?**

Broadly, yes. However there needs to be clarity over when cross-subsidy becomes overt exploitation. There is cross-subsidy in postal services (the price of a stamp for a second class letter from St Ives to Shetland is the same as the price of a second class letter from Lewisham to Chelsea) and in the supply of utilities (gas, electricity etc). The difference here is that cross-subsidy is based on everyone paying the same price for the same service. All too often in financial services cross subsidy is based customers being charged *different* prices – not because the costs of providing the service in each case are different but because some customers are easier to exploit. A good example is in consumer insurance where the loyal customers pay more – despite the fact that it is always cheaper for a company to sell products and services to an existing customer than to sell to a new one.

One might argue that consumers are naïve not to shop around. However, many do not know what price reductions might be available, and do not have the time to make a detailed comparison of alternative quotes every time their household, motor, pet or holiday insurance comes up for renewal. Many suppliers in the insurance industry trade on this. It also seems likely that many people who regularly switch suppliers fail to check fully that the new service that they are buying is exactly the same as the one they were paying for previously. This is partly due to the fact that suppliers sometimes make it very difficult for consumers to make exact comparisons.

**Q10: Does increased individual responsibility increase the need and scope for a greater and more innovative regulatory response?**

In the context of what? Is the MS referring here primarily to things like increased pensions freedoms? If so, then yes; probably greater and more innovative regulation is needed in this area. If the MS is referring to the need for more people to provide for long- term healthcare this is something which needs to be addressed firstly through government policy. If the government decides, for example, that this should be funded through increased NI contributions then it ceases to be an issue for the FCA (or its successors). If the policy is that, say, tax incentives are provided for

individuals to save for care in old age by saving with a financial services provider then this would be very much an area in which the FCA would be expected to have a high degree of oversight.

**Q11: Would a Duty of Care help ensure that financial markets function well?**

Yes, this would be well worth exploring in more detail.

## Protecting consumers

**Q12: Is our approach to offering consumers greater protection for more complex products the right one?**

Not necessarily and, furthermore, it depends how the FCA defines 'riskier, more complex products'. Greatest protection is needed in those areas where:

- Serious loss is not the fault of the consumer
- The loss is likely to be serious or very serious for the consumer / saver.

Examples might include:

- Financial failure of a pension fund (such as Equitable Life). Company schemes now seem to have relatively good safeguards in place following MGN and Maxwell.
- Bank failures; arguably these fall into the category of threats to economic stability. However, it should be noted that there are plenty of people with more than £75,000 of savings with banks – maybe not in deposit accounts but certainly in ISAs and other products run by banks. Even though these assets may be ring-fenced if the provider goes into administration it may take savers months or years to gain access to their assets. For those with investments in stocks and shares this delay could be disastrous.
- Fraud or malfeasance on the part of the provider or loss of information as a result of cyber attack. Many retail investors now are forced to use nominee accounts. The investor is the beneficial owner of the shares. The actual shareholder is the nominee. The ONS estimates that 59% of shares (by value) in UK companies are held in multiple-ownership pooled accounts (nominees). Some of these shares are held by overseas investors. However, of the 12% by value that are held by retail investors it is very likely that a high proportion are held in nominee accounts.

**Q13: Is our regulatory distinction between consumers with greater or lesser capability appropriate?**

See response to Q12 above. How does the FCA plan to define 'greater capability' or 'lesser capability'? Furthermore, these terms have to be defined in relation to specific financial products (see response to Q16 below). One could consider a system of self-certification for some products and then make the purveyor of these products responsible for turning away those who it believes do



not understand what they are buying. Some private equity syndicators already do this. However, it is an approach that provides little practical protection.

Trying to classify risk-vulnerability by type of consumer is not helpful. Risk relates to different financial products / services. It is these that need to form the basis for any 'risk / vulnerability' classification system.

**Q14: Is our approach to redress schemes for issues outside our regulatory perimeter the right one? Would more specific criteria help firms and consumers?**

The FCA's approach to redress in this area is probably the only practical one. However, as stated below, systems of redress should be a last resort. The aim must be to stop the loss occurring in the first place. Ensuring that consumers are better placed to protect themselves is an important factor in this respect. Greater use of lateral thinking may have role to play here. For example, plans to ban pensions cold calling are to be commended. The ban should be extended to cover the selling of all financial services. The idea is extremely simple, does not impinge on the legitimate business activities of genuine providers and sends a powerful message to consumers. Outlawing the practice will not stop thieves and scammers (who may well be based overseas and beyond the reach of the regulatory authorities in the UK) from making cold calls. However, if consumers know that this activity is illegal in the UK there is very good chance that they will be much less likely to succumb to cold calls from criminals and outright confidence tricksters.

**Q15: What more can we do to ensure consumers using redress schemes feel they are receiving the appropriate level of personal attention?**

Probably not much more than the FCA does already. Pro-active measures which seek to reduce the chances that loss and disputes will arise and that redress will be needed must be the aim. Providing redress is a re-active measure. Moreover, as demand for redress increases so the pressure on resources needed to assess each case and provide redress also increases. As resource is bound to be limited service will deteriorate.

## Vulnerable consumers

**Q16: Is our approach of giving more vulnerable consumers greater levels of protection the right one?**

See response to Q13 above. The FCA's distinction between vulnerable and non-vulnerable consumers appears simplistic. How does the FCA intend to distinguish meaningfully between vulnerable and non-vulnerable in the context of, say, opening a bank account? Those with special needs might be considered vulnerable; but are they any more vulnerable than university undergraduates who are trying (with varying degrees of success) to manage their own finances for the first time in their life and who are taking on (often without understanding the full implications) a student loan which will saddle them with high levels of debt for the foreseeable future?

In other cases, the term 'vulnerable' needs to be considered in conjunction with the product/s offered. Pay-day lending is of most appeal to people on low incomes who find it hard to borrow through normal (banking) channels. These people are often (but not always) of lower ability and, in this sense, are intrinsically vulnerable. It is appropriate, therefore, to exercise close regulatory control over pay-day lending.

It is unlikely that doctors, dentists and lawyers will need to resort to pay-day lending. But it does not follow that they are not vulnerable. They are typically not business people and nor in many cases do they have a well developed understanding of complex financial products. Thus they could be vulnerable when offered products which, for example, are based on complex derivatives or contain, say, high levels of exchange-rate risk. Many of the people who were members of syndicates with Lloyds of London in the late 1980s and early 1990s were not vulnerable in the way that the FCA seems to be defining the term. However, they had no idea of the true risks of the commitments they were making (or the nature of the risks they were likely to be underwriting) in becoming syndicate members and many were ruined as a result.

## The role of disclosure in consumers' choices

**Q17: Is our approach to the effectiveness of disclosure based on the right assumptions?**

Broadly, yes.

The notion that 'the more information people have, the more likely they are to make appropriate choices' is patently absurd. Many factors enter into the issue of how people make decisions based on the information they are given, including:

- The amount of information; if people are given large amounts of information there is a good chance that they will not read it or at least will have trouble assimilating it.
- The way the information is expressed; information which is presented in complex legalistic or technical jargon is less likely to be read and, even if it is, it is unlikely to be understood by many people.
- The way the information is presented; people tend to read the things that stand out – headlines, summaries in bold type, text or numbers in colour, 'call-outs' from the main text, simple (possibly-over-simplified) graphics etc.
- The choice of information that is presented; information presented may all be true and correct but the suppression of certain additional information may lead to ill-informed choices.
- The perceived usefulness of the information; often information is presented which fails to answer the 'So what...?' question for the consumer.

One of the problems for the regulator is that a significant amount of information provided by service providers / advisors is sales information. It is not an impartial analysis of facts in the same way that a research report is (or should) be. Too often consumers are given sales information masquerading as factual, unbiased financial analysis. Decision-making by consumers is often based on factors such as emotion and confirmation-bias. Sales and promotional material unashamedly plays on these factors.

**Q18: Given the evidence, is it appropriate for us to take a more 'interventionist' approach where conventional disclosure steps prove ineffective?**

Yes, there is much more that the regulator could do in this area. The advertising standards authority exerts robust control over the claims that can be made in advertisements. The regulator could take a

similar approach to vetting the literature that providers of financial services provide to consumers. As with advertising, consumers and competitors should be encouraged to report bad practice.

## When will we intervene?

**Q19: Do you think our approach to deciding when to intervene will help make FCA decisions more predictable?**

Not necessarily; the approach set out in the MS provides an overview of the factors that the FCA will take into account in deciding when and whether to intervene. There needs to be a clear rationale for intervention but that does not mean that decisions have to be predictable. It is probably more important that decisions should be consistent.

**Q20: Are there any other factors we ought to consider when deciding whether to intervene?**

The most important ones relating specifically to the FCA are discussed. It is important that the various regulatory bodies work together and are seen to work together on decisions about intervention. The response to the failings at HBOS by the regulatory bodies was poor. It would be very damaging for this to be repeated (i.e. an investigation by the FSA completed years after the event and then significant criticism of the FRC for its initial failure to investigate the auditing of HBOS).

**Q21: What more do you think we could do to improve our communication about our interventions?**

Communication about interventions has to be managed on a case by case basis. In some cases it may be better not to say too much about intervention that is under way until the findings of any inquiry become clearer. In other cases it might be appropriate to release fairly detailed information at an early stage.

However, it is not acceptable in cases where there has clearly been wrongdoing and where the matter has been raised with the regulator by consumers for the regulator to refuse to say whether they are taking any action at all. Some of our members have had experience of this with the FSA (as was). The FSA refused to say whether it was going to even contact the company concerned on the basis that this might be prejudicial to the company. This just looked like a smoke-screen for inaction on the part of the FSA. It was certainly very damaging to the FSA's credibility.

Judging by comments in the mission statement, it looks as though the FCA is keen to avoid a repeat of this.

## Competition and market design

**22. Is there anything else in addition to the points set out above that it would be helpful for us to communicate when consulting on new proposals?**

No, this is generally well covered.

## Supervising firms

### **Q23: Do you think it is our role to encourage innovation?**

This is an interesting section in the Mission Statement. The comments cast the FCA in the role of a strategic procurement function which is overseeing the supply market to ensure that devolved buyers can access the right products, of the right quality, from the right suppliers, at the right time and at the right price (the 5 'rights').

Encouraging Innovation is not really part of this activity except in cases where supply is concentrated in the hands of one or a few suppliers who are offering poor service at relatively high prices. In this situation we might expect to see the FCA actively seeking to encourage new suppliers to enter the market to promote greater competition and, where appropriate, innovation. This seems to be entirely consistent with the competition goals that the FCA has set for itself.

### **Q24: Do you think our approach to firm failure is appropriate?**

Yes; this is another role that a strategic procurement activity would normally take on. It is never helpful for buyers (consumers in this case) to be taken by surprise by the failure of a supplier. In some cases, such as the failure of a bank, the wider impact on the economy could be cataclysmic. It would be entirely appropriate for a regulator (or regulators acting in concert) to manage an orderly winding up of a failing business and transfer of the customers to other suppliers.

## Our approach to enforcement

### **Q25: Do you think more formal discussions with firms about lessons learned will help improve regulatory outcomes?**

Yes, we cannot see any disadvantages in this. It should be of benefit to all concerned.

### **Q26: Do you think that private warnings are consistent with our desire to be more transparent?**

No; it would be better to be as transparent as possible. It might not be possible to give all the detail surrounding the warning but it should at least be in the public domain that a warning was given. Some information should also be given about the reason for the warning.