The Financial Inclusion Centre

Financial markets that work for society

FINANCIAL CONDUCT AUTHORITY (FCA): OUR FUTURE MISSION

SUBMISSION BY THE FINANCIAL INCLUSION CENTRE

The Financial Inclusion Centre is pleased to submit a response to the FCA's 'Mission' document consultation. We are very encouraged that the FCA is consulting on its mission. The document itself is very helpful for communicating the FCA's priorities and how the FCA approaches its work.

In particular, we are very pleased about the greater emphasis now placed on vulnerable consumers. We support the view that resources should be concentrated on vulnerable consumers who are less able to withstand the impact of market failure or consumer detriment. This is more evidence that the FCA is adopting a more consumer-focused regulatory culture.

We look forward to seeing the results of the consultation and working with the FCA to develop the mission.

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SPECIFIC QUESTIONS

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

It is quite difficult to discern in the Mission Document what the FCA actually means by a well-functioning market. The FCA talks about the conditions that must be met for well-functioning markets to occur, and states what a well-functioning market *is not.*

We define a well-functioning market as one which produces the right outcomes for consumers and the real economy. These outcomes, which can be adapted for specific sectors such as banking, insurance, consumer credit etc, are:

1. Access and usage: consumers (in the wider sense) should have access to and choice of appropriate products and services, and use those products effectively.

2. Safety and security: financial institutions should be safe and prudently run, the financial system resilient, products and services should be safe and legally secure, and financial institutions and individuals authorised to high standards.

3. Fairness and integrity: consumers should be treated fairly, financial institutions and market practitioners should operate with integrity.

4. Performance and efficiency: markets should be efficient, sustainable and produce value for money, quality, functional, socially useful products and services that meet the core financial needs of consumers.

5. Decisions and choices: consumers should have the necessary information, advice and financial capability to make the right financial decisions and choices.

6. Redress and accountability: consumers should have access to well-resourced redress and guarantee schemes and wrongdoers held to account for detrimental behaviours.

7. Confidence and trust: consumers should have justified confidence in markets and institutions that deserve their trust.

But of course markets have to be judged how well they undertake primary economic functions, not just serve the needs of consumers.

The financial system and financial markets are very complex but there are four primary functions: banking, money transmission and payment systems; resource allocation and asset management (the gathering and allocation of resources within the financial and economic system); financial intermediation, credit creation, and maturity transformation; and insurance and risk management.

In undertaking these functions, financial institutions provide products and services to clients – for example: pension funds provide the vehicles to help people save for retirement and also channel capital to real economy firms or government; financial intermediation and credit creation provides mortgages supposedly to help people afford to buy a home, and credit to smooth consumption; the diversification of risk around the financial system allows insurers to provide insurance products to households and firms.

The financial system and markets can be said to be economic and socially useful if they perform those functions well.

We have developed an economic and social audit framework to assess whether markets are working. Well-functioning markets: are safe, secure, and resilient; are efficient and socially useful; create limited externalities; and have the confidence and trust of consumers (clients) willing to engage.

We can only judge whether wholesale and capital markets are working if the following outcomes are evident. Responsibility for ensuring some of these outcomes are met is shared with the Bank of England and PRA – but given that we are focusing on the economic and social utility of markets, the primary responsibility lies with the FCA.

Table 1: FIC ECONOMIC AND SOCIAL AUDIT OUTCOMES FRAMEWORK

Well-functioning system and markets	**Poorly-functioning system and markets**
Safe, secure, and resilient The financial system and important network institutions are safe, secure, and resilient. Achieved through sound	System and institutions are vulnerable to systemic risks and external shocks; poorly managed and regulated; emphasis on short

management, effective regulation, and having sufficient plurality and diversity in the system	termism creates volatility; homogenous, concentrated markets with little diversity and plurality create systemic risks; high risk of contagion from financial markets to wider economic system
Efficient and socially useful Markets are efficient and socially useful so that: pools of investable capital and resources are allocated to economically productive, socially useful, sustainable, value creating activities and ventures; incentives and attitudes encourage long term, patient investment decisions; efficient so that value is not extracted from investments, financial institutions recognise their critical stewardship role; markets are accessible and inclusive	Market supply chain extracts value from investors capital, high levels of capital and resources are concentrated in speculative activities, short-termism dominates, pools of investable capital and resources are directed to rent-seeking or speculative activities, not recycled for economically productive and socially useful activities
Creates limited externalities Financial market activities and behaviours do not create major externality costs for society. This means: market failure is contained within the financial system not transmitted to the wider economy/ society; externalities are priced into financial market activities, market failure borne by financial institutions not by society – for example, banks underwritten by implicit taxpayer subsidies, taxpayers subsidising inefficient pension providers through pensions tax relief	Markets create externality costs including: financial markets are of national economic interest so have benefited from direct bail-outs and implicit insurance provided by the rest of society; over-financialisation harms economic productivity and exacerbates existing structural economic inequality; market behaviours can also exacerbate existing economic inequality both intra and inter-generational (for example, through the creation of asset price bubbles); financial and social exclusion, environmental damage caused by short-termism
Confidence, trust, willingness to engage Financial system, markets and institutions have the confidence and trust of investors and society, are transparent, populated with financial institutions and market practitioners that behave with integrity and treat clients fairly; confidence and trust in markets is high so that households and firms engage with and are willing to use financial markets	Failures to exercise duty of care, misselling episodes undermine consumer confidence and trust in markets; major conduct costs hit the bottom line affecting available capital for lending and investment; failures to communicate risk/ reward to clients means expectations are not met; confidence and trust is low, households and firms disengage with markets (not saving for pension with social impacts, as investors not willing to provide capital to the financial system)

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

It is accepted that we cannot have a zero-risk financial system. However, this philosophy should not be used as reason for transferring an unreasonable degree of risk to consumers. Moreover, it is important that in an era defined by low interest rates, low growth steps are taken to ensure that risks are communicated to consumers by producers and intermediaries.

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

The FCA states that: '*at a high level, financial conduct regulation aims to prevent or correct information asymmetries by reducing to an acceptable level the problems that can arise through imbalances in access to information, or the ability to understand and process that information*'. The FCA then goes onto say that: '*As well as helping to reduce the impact of information asymmetries between providers and users, effective regulation has wider benefits*'.

This reinforces the view that the FCA sees the primary aim of regulation as dealing with information asymmetries. We strongly take issue with this. The aim should be to *make markets work* for households and the real economy. The fact that information asymmetries may or may not exist should be of secondary importance. It is much better for regulators to make markets work and allow information asymmetries to remain than to waste time and resource in a well-meaning but ultimately vain attempt to rid the market of information asymmetries in the hope that this will indirectly make markets work.

We should not forget that other market regulators are also defaulting to tackling information asymmetries to try to create the right conditions in their respective markets. Financial regulators cannot consider the potential effectiveness of information disclosure in a vacuum. Consumers are facing information overload. Being a consumer is almost becoming a job in its own right.

We find it hard to understand why the FCA articulates this high level aim given the evidence of history which points to the failure of information asymmetry theories to explain such high levels of market failure in financial services but, more importantly, the very limited effectiveness of information/ demand side solutions to produce the right outcomes for consumers.

There are a range of explanations for the market failure observed in financial markets. Information asymmetry is the classic economic theory which traditionally has been used by regulators and economists. Other explanations include conflicts of interest in the supply chain, oversupply in markets, structural problems, deliberate confusion marketing, unnecessary product complexity, and the basic nature of competition in a market (for example, innovation driven business model needs, not consumer needs, competition for distribution not the end-user).

Of course, economic theoreticians would hold that addressing the information asymmetry problem would resolve the other problems relating to conflicts of interest, encourage effective competition so the equilibrium point is reached in terms of numbers of suppliers in a market, promote competition for the end-user not distributors, and so on.

But, it is important to note that the value of any theory depends on two things. Firstly, how well does a theory explain market failure? But, secondly, and more importantly, how well can that theory be acted upon to produce the outcomes we seek.

It is possible to cite information asymmetry to explain market failure; and, in an ideal world, it would be possible for conduct regulators to tackle information asymmetries to such effect that consumer behaviour would drive the types of market and corporate behaviour we seek.

But that ideal, model world does not exist. There are few markets in financial services which are demand-led (actually even outside of financial services the extent to which markets are demand-led is exaggerated). Moreover, it is difficult, given the lessons from history, to argue that demand side

interventions would ever be effective enough to correct the information asymmetry problem. We do not understand why regulators continue to pursue the information asymmetry model.

But there is a more basic issue regarding the prioritisation of resources by the FCA. The FCA's primary goal, in our view, is ensuring that financial markets and institutions treat customers fairly, produce good value, socially useful products and so on. The question is: how best to achieve that? There are two basic approaches:

- Demand side interventions/ tackling information asymmetries: the theory is that by empowering consumers, they will then exert influence/ competition pressures on firms, in turn improving corporate and market behaviours.
- Supply side interventions: the alternative approach is for regulators to directly intervene to influence or constrain corporate behaviours that are causing harm.

The information asymmetry approach, for the most part, has not worked in financial services. This can be seen in the lack of real changes in the current account market following a number of competition reviews which preferred demand side interventions, the historic failure of disclosure in the life and pensions market, the failure of disclosure to protect consumers in the payday lending market, and recent evidence produced about chronic market failures in the asset management sector (a sector which historically has been replete with market information). Nor is there good reason to believe that information disclosure will work in future. But the lack of evidence as to the effectiveness of demand side interventions does not seem to have dampened faith in this approach. When previous attempts at using information disclosure and other demand side interventions have failed to produce the desired results, this has been explained away as the conditions not being right, information not being sufficient or presented in the right way.

In contrast, we can see that direct regulatory interventions do work. The introduction of stakeholder pensions and the RU64 rule transformed the personal pensions industry, structural reforms transformed the with-profits and unit-linked insurance industry, the Retail Distribution Review and Mortgage Market Review transformed those markets, price caps transformed the payday lending sector while, more generally, targeted supervision of meaningful conduct of business and product governance standards has seen the FCA rightly congratulated for producing real improvements in the culture and behaviours in retail financial services.

The amount of regulatory effort and resource required to change sufficient numbers of consumers' behaviours to influence corporate behaviours is daunting. Whereas, direct regulatory interventions can improve the behaviour of major corporates which in the case of large institutions can then directly improve the welfare of millions of consumers.

The more realistic regulatory approach adopted by the FCA recently is not burdensome or disproportionate. It simply codifies the standards of behaviour expected of well run businesses and markets.

Of course, some in the industry (and some economic commentators) will argue that more intensive, realistic regulation has unintended consequences such as stifling innovation and competition. But, we cannot think of a major, genuinely socially useful financial innovation that has been/ would have been prevented from coming to market as a result of more interventionist regulation. Indeed, we would argue that tough regulatory interventions actually *clears space* for innovative, competitive providers. Tough regulation encourages the right type of competition.

Of course, we do not suggest that consumers should be denied information. Just that information asymmetry is not a very helpful framework for understanding market failure and that information disclosure and other demand side interventions should not be the primary regulatory tool for the FCA to correct market failure.

Information can be useful in the hands of trusted intermediaries such as consumer groups. Moreover, information can be used more effectively if regulators place a tougher duty of care on producers and financial intermediaries (financial advisers and information providers) to explain information but more importantly to not exploit information asymmetries when engaging with consumers.

It is also important to get the sequence of interventions right. The FCA should focus on cleaning up markets, improving the quality and reducing the cost of products, tackling conflicts of interest along the supply chain so that the various producers and intermediaries act in the interest of and compete for the business of the end-user, and improving the corporate governance and cultures in firms.

Therefore, we would argue that the primary aim of conduct regulation (when used alongside market forces and standards of corporate governance) should be to *make* markets work so they produce the right outcomes for consumers, not to *create the conditions* for markets to deliver. This means, in practice, regulators adopting a *managed* markets or *bounded* markets approach which involves policymakers and regulators placing bounds on acceptable behaviours and managing markets so they improve. Creating the conditions for markets and leaving markets to their own devices is not effective in financial services.

More generally, we are concerned about the growing emphasis the FCA is placing on conventional economics and competition theory to understand financial markets and select interventions to make those markets work (for example, see page 11 of the Mission document). The philosophy espoused in the document seems to be that if only the right demand and supply side conditions could be created, then it will follow that markets will produce the right outcomes for households and the real economy.

In an ideal world, competition theory might be applied to good effect. However, in the real world, markets are very different. Direct regulatory interventions are more effective and can be more efficient in terms of regulatory resources compared to market studies which tend to be slower, are more open to challenge from industry, and tend to approach a market failure from a flawed competition 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?

It is helpful to distinguish between retail, wholesale and capital markets. But, we would make a number of points.

When describing retail markets, the FCA again talks about the *conditions* for markets to work well as including consumers making informed decisions. But consumers will continue to exert limited actual influence on the price and quality of products and services. These market features are primarily determined by producers and intermediaries, and they will continue to do so. Regulators are in a much stronger position to improve markets than consumers.

It is not clear where the FCA envisages ‘institutional’ clients such as pension fund trustees, local authorities, or charities fitting into this classification. We would dispute that these are *sophisticated*

clients. Indeed, they can be just as susceptible to poor, misleading or conflicted advice from financial intermediaries. Moreover, given the sums of money involved, the welfare loss can be greater.

More generally, with regards to wholesale and capital markets, the FCA considers the important conditions to be resilience, accessibility, checks on dominant providers having too much market power, and price transparency.

Again, this is very much a competition mindset, the theory presumably being that as long as customers can access services, there are sufficient providers to meet the conditions for competition, and information is provided to clients/ exchanged between parties, well-functioning markets will automatically follow.

It is not clear whether the FCA has concluded that wholesale, institutional and capital markets are actually working well or that it presumes the conditions exist. We say this because although the FCA in the past has looked at whether certain indicators of competition exists, we are not aware of comprehensive studies which analyse whether wholesale markets are actually producing the desired outcomes for the real economy.

There is no question that wholesale, institutional and capital markets are huge and complex and there is a furious degree of activity and 'innovation' in these markets. But activity should not be confused with the right outcomes.

We can only judge whether wholesale and capital markets are working if the outcomes described above in the social audit framework are evident. But, the evidence has not been gathered to allow anyone to judge whether wholesale, institutional and capital markets are actually working.

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

We support the broad framework set out in the Mission paper particularly the intention to measure impact and outcomes.

That high level framework should allow the FCA to better measure the '*return on intervention*' – that is, how much improvement in markets has been produced through regulatory interventions compared to resources expended – and to enhance accountability by reporting that more transparently to the public.

More fundamentally, measuring market impacts and outcomes is a much more meaningful way of judging markets compared to using conventional competition indicators such as number of providers and products in market, price dispersions which tells us little about whether markets are producing the right outcomes. But this emphasises the importance of choosing the right outcome measures.

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

Yes, we support the intervention framework. The FCA is to be rightly commended for becoming clearer about the outcomes it is trying to produce and progress in identifying risks. The risk identification and business planning process is much more transparent and better understood.

The framework included in the Mission paper is similar to the five stage model we use (which in turn is adapted from the European Commission's Financial Services User Group (FSUG) model set out in the paper, New Model Financial Regulation[1].

The framework below sets out the five stage model for retail markets. But this can be adapted for institutional, wholesale and capital markets.

Stage 1: Define objectives and outcomes to provide strategic direction
Define clear strategic objectives preferably enshrined in legislation.
Define clear, measurable outcomes, market success measures and metrics to allow regulators to measure whether outcomes are met. The outcomes may include:

Access; appropriate choice; fairness and integrity; safety, resilience, and sustainability; value for money and efficiency; functionality and social utility; information and advice; financial capability; redress and compensation; accountability to users; and consumer confidence and trust.

Stage 2: Identify and measure detriment and market failure
Measured against consumer outcomes, identify existing and potential detriment using financial impact assessment tools; assessment of risks to consumer outcomes can be undertaken by identifying market behaviours that are more likely to result in detriment.
Risk assessment function should also model impact of external economic/social/commercial factors on consumer outcomes.
Use quantitative and qualitative analysis tools to establish consumer welfare loss/detriment, establish impacts on different groups of financial users – especially vulnerable and disadvantaged users, establish dimensional detriment – firm/institution specific, sector wide, product specific, supply chain, systemic.
Establish market intelligence systems, databases to monitor markets.

Stage 3: Establish root causes of detriment and market failure
Detriment and market failure occurs because of a range of demand side, interface problems, supply side, and external factors including: information asymmetries[2], conflicts of interest, failure of fiduciary duty, poor financial capability, consumers' cognitive limitations, product complexity, anticompetitive practices, oversupply, aggressive market behaviours, distribution/acquisition strategies, over-intermediation, inefficient gatekeepers, socio-economic conditions.

Stage 4: Identify effective interventions and remedies
Robust authorisations procedures, prudential regulation, information disclosure, financial education[3], market rules, product intervention including product banning, setting minimum standards, tough sanctions, redress, mass consumer actions, structural reforms, competition referrals, alternative products and providers. Interventions should be selected to address root causes of detriment/market failure. The scale of detriment and market failure may require a portfolio of interventions rather than single intervention.
Public policy implications and unintended consequences should be understood.

Stage 5: Prioritisation
Finite resources mean that issues and interventions must be prioritised. Prioritisation should be

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[1] See http://ec.europa.eu/finance/finservices-retail/fsug/papers/index_en.htm September 2012
[2] But note the limitations of relying on information asymmetries to explain detriment and information solutions to make markets work
[3] Note also that financial education as a demand side intervention is not effective at levelling the playing field between consumers and producers

based on: level of detriment and impact on financial users (with emphasis on vulnerable users); effectiveness – the likelihood that interventions are to be effective at correcting market failure; the 'return on intervention'; and available resources.

While we agree with the intervention framework set out in the Mission paper, the important thing is to ensure that the actual, or rather to be more precise the *actionable*, causes of market failure are identified and the most effective interventions are chosen to correct market failure. As explained in some detail above, information asymmetries are not very helpful in explaining market failure and information disclosure is not a particularly effective way of making markets work.

Moreover, we are concerned about the effectiveness of market studies and competition approach now seemingly favoured by the FCA. Market studies take much longer than regulatory interventions and thematic reviews.

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?

N/A

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

We are very pleased that the FCA is considering the boundary between regulatory policy and public policy. We are of the view that the FCA is not a public policy regulator. Public policy, social policy and national economic policy is ultimately the responsibility of government departments.

Nevertheless, the FCA has a clear role in ensuring regulatory policy contributes to effective public and social policy. There are a number of examples of this.

There are occasions where the regulator is mandated to implement public and social policy. A good example of this is ensuring compliance with the Payments Accounts Directive which amongst other things gives consumers in the UK a legal right of access to a basic bank account. This should now be a priority for the FCA if it wants to demonstrate its commitment to vulnerable consumers.

The FCA has significant resources at its disposal to undertake research into the utility of financial markets particularly with regards to the capacity of retail markets to serve the needs of hard to reach, vulnerable consumers in a way that is commercially viable for providers and fair to those consumers. It should be bolder in advising policymakers that markets are failing certain groups of consumers or that there are limits to market-based provision and make specific recommendations for alternative provision.

In the FCA makes markets more efficient, this can contribute to public policy as this in theory should extend the ability of providers to reach more consumers (if unit costs are reduced).

The FCA can be aware of the impact of its regulatory interventions and advise government and other stakeholders on wider issues such as the impact of financial market behaviours on public policy priorities such as building financial resilience. The current low savings ratios and growth in unsecured credit amongst certain groups of consumers is a real cause for concern. This, of course, is driven largely by the fact that many households have seen little improvements in real disposable

incomes post financial crisis. But, it is also partly driven by the emphasis placed on different products by financial institutions. Aggressive selling of consumer credit products can displace savings behaviours.

Clearly, the FCA in promoting confidence and trust in markets can make a contribution to public policy objectives such as getting people save enough for retirement, or encouraging real economy firms to re-engage with the banking sector to obtain finance.

The FCA can also be more proactive in warning government as to the merits and risks of public policy proposals. The badly planned and poorly executed pensions 'freedom and choice' reforms are a case in point.

The FCA can also make a clear contribution to national economic policy by ensuring that financial markets are economically and socially useful (see our response to Question 1, above).

There is a more general point to make about the social justice approach to regulation needed to protect vulnerable consumers (see below).

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

Yes, we very much support the way the FCA sets out the risks of price discrimination arising from the combination of increasing use of technology and 'big data'. It is a welcome counterweight to some of the more 'evangelical' claims being made for fintech and big data. While it is clear that fintech may lead to more efficient distribution in some areas, it is equally important to recognise that greater segmentation and price discrimination is generally associated with greater financial exclusion.

However, it is not clear what approach the FCA is actually proposing in the Mission document. If these developments are taken further, we could end up with significant problems relating to financial exclusion and price discrimination. The logical conclusion is that government will either have to limit the use of discriminatory practices, mandate provision of certain products and services, and/ or provide or encourage the provision of, alternative products and services. The FCA may be able to help at the margins by encouraging innovative new providers into the market who can engage with underserved groups. But, it is more likely that innovative providers will want to target more profitable, less risky pools of consumers thereby exacerbating price discrimination.

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

First of all it is important to note that increased individual responsibility is not a given. The transfer of risk and responsibility to individual consumers is a policy choice. Nevertheless, given that this is happening, the question is how do we respond to this transfer? It certainly requires a greater regulatory response to level the playing field between consumers and the market place. But, we are not clear what the FCA means by a more 'innovative' regulatory response.

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

We do share some of the FCA's views that the existing regulatory principles create what is in effect a duty of care. But, having said that, we do believe that an explicit Duty of Care has considerable

merits. As the FCA points out, it would help consumers (and their representatives) to use the courts to take action against firms. This should act as a disciplining force on firms and more importantly directors and senior management. Secondly, we also think it would focus the minds of market actors who would be reminded every day who they had a duty of care to. Thirdly, we also think there could be an additional benefit for FCA supervision. A duty of care would also provide a focus for FCA supervisors to robustly challenge firm and senior management behaviours.

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

Yes, we very much support the approach. The greater the complexity, the greater the risk involved for consumers generally. A good risk based approach to regulation will tailor regulatory interventions according to the risk presented by the product, activity or behaviour.

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

Yes, we also very much support this approach. This is elaborated on in our response to Q16 on vulnerable consumers. But, it is worth reiterating that the capability of 'consumers' in institutional markets (such as pension funds) should not be overstated.

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

Yes, we think this is right approach. But, this raises a wider problem with financial legislation and regulation. Over the years, the UK approach to legislating and regulating has in the main be very slow and reactive to problems emerging. This is partly due to the prescriptive nature of legislation – financial activities have to be designated as being within the perimeter and within the FCA's scope. We would encourage the FCA and HMT to investigate whether it is possible for a more permissive approach to be adopted where broad categories of financial activities are defined at a high level (savings, investment, lending, insurance) and then allowing individual products to be quickly brought into the scope of the FCA using secondary legislation at the instigation of the FCA.

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

We have no comment on this beyond the point we make below in response to Q16 that more needs to be done to ensure that redress schemes (and regulation generally) is not just for 'Middle England' consumers but works for all consumers.

Q16: Is our approach to giving vulnerable consumers greater levels of protection the right one?
We are very encouraged indeed by the FCA's approach to protecting vulnerable consumers.

In a modern consumer society, our rights as citizen-consumers are supposed to be paramount when dealing with private markets.

One of the key elements of social justice theory is that vulnerable consumers have the right to expect equality of outcomes with other consumers when dealing with organisations. Outcomes might include: access to appropriate services, quality of services and value for money, being treated fairly, enforcement of rights, and protection from harm. Note this does not mean that markets

should be required to provide products to all consumers at the same price or ignore risk profiles of consumers when setting prices. That is a matter of public policy – see above.

In recognition that consumers, as individual agents, have limited influence on provider behaviours in key private markets, regulation is deployed to improve the chances that consumers get the appropriate outcomes. Alternatively, agencies or representative organisations (such as advice agencies and consumer organisations) exist to 'level the playing field' between consumers and producers/ suppliers.

But to try to ensure equality of outcomes, social justice theory also holds that the more vulnerable a consumer is, the greater the level of protection they should have in legislation and regulation from unfair treatment and practices, or they should have dedicated agencies acting on their behalf to ensure their needs are met and rights enforced.

However, there are concerns that, in practice, what we currently have is an 'inverted pyramid' of rights and protection. The concerns can be summarised as:

- Better-off/ more capable consumers derive additional benefit from the protection afforded by statutory consumer rights, regulation, complaints and redress schemes enforced by well-resourced independent regulators; they are able to navigate and use regulation and redress schemes effectively; and they have the support of well-resourced consumer champions and media to raise concerns with regulators, fight their corner, lobby for reform and so on.
- Historically, markets used by poorer, vulnerable consumers have tended to be less well-regulated – or to be precise less well-supervised; vulnerable households may be less able to navigate regulation and redress schemes; and they do not have the same backing from well-resourced consumer advocates and media.

To be fair, this has been changing as the example of payday lending regulation shows. But, it is worth reiterating that markets used by vulnerable consumers are still likely to remain under the radar or outside the regulatory perimeter.

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

We are pleased that the FCA has recognised the limitations of disclosure in Chapter 9 of the document. But, this does seem somewhat at odds with the tone of previous chapters which focuses on dealing with information asymmetries as the primary high level regulatory objective.

We do support the use of behavioural insights such as nudges to promote better consumer behaviours. But it would be perhaps more effective if the FCA focused its work on behavioural insights to target and influence behaviours of product manufacturers and intermediaries.

We still do not understand why the FCA continues with the philosophy of trying to make the demand side work better and seems to treat other more successful direct supply side interventions almost as a last resort. Over the years, regulators have tried information disclosure, then financial education interventions. These demand side interventions have not been effective. But rather than reaching first for interventions that have been shown to work, the FCA seems intent on trying yet another demand side intervention – this time in the form of behavioural interventions - before going onto try direct interventions. The FCA should be neutral and objective, and select the most effective regulatory intervention.

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

See above. There is no logic to insisting on trying disclosure interventions first before deploying proven direct interventions.

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

Yes. As we explain in our answer to Q6, we very much support the FCA's intervention framework. This should help make FCA decisions more predictable. Our main concern as mentioned is how quickly the FCA can identify and respond to emerging detriment.

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

No, we think the FCA proposed model is clear.

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

We have no further comment to make on how then FCA should communicate other than is set out in the paper.

Q22: 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?

We have no additional comments to make on how the FCA should communicate *to* stakeholders. But, we would suggest that if the FCA wants to become more inclusive, and keep on top of new thinking in the consumer protection field and avoid group-think, it should do more to engage with stakeholders.

However, our main concern relates to the general philosophy espoused in Chapter 11 and throughout much of the paper. There is too much emphasis on using competition as the primary mechanism for making markets work. Of course, we all want to see markets that are truly competitive. But, there is little reason to believe that *creating the conditions* for competition will ever work very well in complex markets such as financial services. Markets have to be *made to work*, to produce the desired outcomes. This means intervening to change behaviours, drive up standards and quality. Most importantly, it means selecting the best regulatory interventions for tackling identified detriments, not defaulting to 'competition' as the primary mechanism.

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

Yes. But the FCA has to be clear and confident about using its judgment to promote socially useful innovation rather than innovation per se.

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

Yes. We think the approach is appropriate. We would raise one point about the need to make special arrangements to protect the customers of firms that fail in the less well scrutinised sectors such as debt management and consolidation.

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

We have no comment about discussions with firms. But we would certainly advocate the FCA discussing with consumer advocates about lessons learned. This would improve the understanding of consumer advocates, help the FCA learn lessons about how to improve regulation, and help build longer term relationships.

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

Yes, in this case private warnings can be a helpful way to influence firm and market behaviour. But, of course, we would say that the FCA should be reviewing its overall approach to transparency. Greater disclosure and transparency should be the default setting. There are few genuine occasions where thinking on regulatory decisions needs to be kept under wraps.

This marks the end of The Financial Inclusion Centre submission
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