**FCA Call for Input**

**Review of FCA requirements following the introduction of the Consumer Duty**

**Submission by The Financial Inclusion Centre**

## About The Financial Inclusion Centre

The Financial Inclusion Centre (FIC) is an independent, not-for-profit policy and research group (www.inclusioncentre.org.uk). FIC's mission is to promote a financial system and financial markets that work for society. FIC works at two main levels:

### Promoting system level change

Research and policy development to promote sustainable, resilient, economically and socially useful financial markets that: benefit the environment; encourage responsible corporate behaviours and create a positive social impact; and efficiently allocate long term financial resources to the real economy.

### Ensuring households' core financial services needs are met

Promoting fair and inclusive, efficient and competitive, well-governed and accountable, properly regulated financial markets and services that meet households' core financial needs. We do this by: undertaking research into the causes of market failure in the sector; formulating policies to address that market failure; developing alternative solutions where the market cannot deliver; and campaigning for market reform. We focus on: households who are excluded from, face discrimination in, or are underserved by financial markets and services; and the intersection of finance, technology, and data.

## Introduction

We are pleased to make a submission to this important Call for Input. For further information, please contact:

Mick McAteer
Co-Director
Financial Inclusion Centre

mick.mcateer@inclusioncentre.org.uk

## Summary of our position

- FIC supports efforts to restructure the FCA Handbook and streamline rules that produce no benefits for consumers and business, as long as consumer protection standards are maintained.
- But, we are very concerned about the potential risks with this initiative especially as it is happening at the same time as the Advice/ Guidance Boundary and Consumer Credit Act reviews. Financial services lobby groups are using 'Trojan Horse' arguments that current consumer protection standards stifle financial innovation and competition, hinder financial inclusion, and hold back the competitiveness and growth of the UK financial sector and wider economy.
- There is no evidence that current consumer protection standards have these effects. Yet, Government and financial regulators appear sympathetic to industry arguments. Government is pressuring the FCA to do more to support the growth and competitiveness of the UK financial sector.[1] The FCA uses unfortunate phrases such as 'regulatory burden on business',[2] which implies the FCA has already decided there is too much regulation even before the Call for Input or other reviews are completed. We are concerned the FCA will come under further pressure during this review to reduce consumer protection standards. We hope the regulator resists this pressure.
- The FCA wants to move more towards high level rules leaving firms more discretion on how to interpret and apply the rules. Current regulation could have been based on high level principles and rules. Sadly, in financial services, firms could not be trusted - or could not trust themselves - to responsibly interpret and comply with high level regulatory principles and rules. Over the years, the industry has had to be told in ever increasing detail by the regulator what is expected of them with the result that the current Handbook and guidance is now very detailed.
- However, even though the Handbook rules and guidance is very complex, it is important to recognise that the main costs associated with regulation do not arise from firms having to read a complex rule book. The main costs come from firms internalising and operationalising regulatory expectations, setting up systems and processes, and employing risk and compliance professionals to comply with regulation, and avoid FCA sanctions and paying redress to consumers.
- So, moving to a high level rules approach and streamlining the rules *per se* will not materially reduce industry costs, or change firms' 'risk appetites' - *if* consumer protection standards are maintained. And it is a big *if*.
- With high level rules, firms would still have to operationalise regulatory expectations. Indeed, if the certainty provided by detailed rules and guidance is removed, firms could find it more, not less, challenging to comply with regulatory expectations. This is critical. Industry lobbies recognise that streamlining rules and guidance will not materially reduce costs or change risk

[1] Reeves to tell UK financial watchdog to prove it will support growth
[2] Financial regulator seeks to reduce burdens on firms and support growth | FCA

appetites. Instead, we think the industry lobbies could push for redrawing the regulatory boundary in firms' favour during this Call for Input and the Advice/ Guidance Boundary and Consumer Credit Act reviews. In other words, they will push for more of the risks and costs of misselling and other market failures to be transferred to consumers.

- If the FCA redraws the regulatory boundary, this might make the industry appear more competitive in the short term (if 'competitive' is taken to mean regulatory costs for the industry being reduced). But, this could enable more misselling and selling of unsuitable products and undermine the FCA's primary consumer protection and competition objectives. This would damage trust and confidence in the industry and its long term competitiveness, which would in turn undermine the FCA's competitiveness and growth objective.
- We do not know yet what the industry will propose or how the FCA will respond. But, we urge the FCA to:
    - publish a full list of proposals submitted by the industry;
    - publish an assessment of the proposals on consumer protection standards; and
    - with regards to revising how information is disclosed, conduct research with consumers to gauge understanding.
- Unlike other consumer markets, competition and innovation has not been very effective at producing good consumer outcomes in retail financial services. Whereas, robust regulatory interventions have driven major improvements. While we do think it is possible to restructure the Handbook, moving to a more high-level rules based approach, and allowing firms more discretion on how to demonstrate compliance with regulatory expectations, could make it more difficult for the FCA to monitor and supervise market behaviours. Therefore, any proposed changes should be assessed for the potential impact on the FCA's ability to exercise its supervisory and enforcement functions.
- We urge the FCA to create an independent advisory committee comprised of consumer representatives to scrutinise and advise the FCA on the potential impact of any proposals.
- There are clearly issues with regards to access to affordable credit, insurance, and advice to help consumers build financial resilience – see Annex I. We need to accept there are millions of consumers a well-regulated market just cannot serve on terms that suit both consumers and commercial firms. Weakening consumer protection and redrawing the regulatory boundary would not be a sensible solution to promoting inclusion, or socially useful innovation. There are better alternatives including: supporting the non-profit community lending sector; expanding the use of workplace payroll savings schemes which also support credit unions' ability to provide loans;[3] supporting the expansion of deduction based lending;[4] supporting the development of alternative basic low cost insurance products; allowing debt advice charities to play a bigger role in providing limited advice on basic products, and signposting consumers to appropriate non-profit providers; and improving the way information is used in credit risk assessments to build a bridge back to financial inclusion.[5]

[3] See: Getting Workforces Savings-Payroll Savings with Credit Unions | The Financial Inclusion Centre
[4] New research shows deduction lending adds up for low income borrowers and lenders | The Financial Inclusion Centre
[5] For example, as proposed by Registry Trust The Data That Matters


Financial Inclusion Centre, 2nd Floor, 113-115 Fonthill Rd, London N4 3HH
www.inclusioncentre.org.uk
Non-profit organisation, Company limited by guarantee
Company no: 06272007, Vat No: 144925501

## Response to specific questions

**Question 1: Could any of our retail conduct rules or guidance be usefully simplified or removed by relying on requirements under the Consumer Duty? Please tell us: a: which rules or guidance (e.g. Handbook chapters, or non-Handbook guidance) you consider cover similar ground to Duty requirements, or are otherwise overly detailed or prescriptive, or arguably redundant in light of other materials, and why; b: your thinking on the likely benefits including, for example, any estimate on compliance cost savings; and c: what the impact could be on consumers or consumer protection, or other relevant considerations**

To be clear, the Financial Inclusion Centre fully supports efforts to address the duplication of rules and guidance that produce no benefit for consumers. We have no objection to removing rules or guidance as long as consumer protection standards are maintained. It may be possible to edit and structure the Handbook to make it clearer, simpler, and shorter for example by removing certain rules from the specific product rule books if these are covered by the Consumer Duty (and firms understand this).

We do not have the resources to scrutinise the Handbook and non-Handbook material to be able to make specific recommendations. Our main concern is to address the risks of this Call for Input being used by financial sector lobbies to push for an actual weakening of consumer protection standards.

This Call for Input is happening at the same time as the Advice/ Guidance Boundary Review and review of the Consumer Credit Act. Financial services lobby groups have been effective at deploying 'Trojan Horse' arguments that current regulatory standards and consumer protection measures stifle financial innovation, hinder financial inclusion, and hold back the competitiveness and growth of the UK financial sector and wider economy. There is no evidence that current regulation has these effects.

Yet, Government and financial regulators appear sympathetic to industry arguments about the effects of regulation. Government is pressuring the FCA to do more to support the growth and competitiveness of the UK financial sector.[6] The FCA uses unfortunate phrases such as 'regulatory burden on business',[7] which implies the FCA has already decided there is too much regulation even before this Call for Input, and Advice/ Guidance Boundary and Consumer Credit Act reviews have been completed.

Therefore, although the FCA has said it wants to continue to support and protect consumers, we are concerned that as a result of this initiative the FCA will come under further pressure from Government and industry to weaken consumer protection standards to support competitiveness and growth, and promote financial inclusion.

The combination of Advice/ Guidance Boundary and Consumer Credit Act reviews, and this Call for Input means there is a real risk the boundary of regulatory responsibility will be redrawn in the

[6] Reeves to tell UK financial watchdog to prove it will support growth
[7] Financial regulator seeks to reduce burdens on firms and support growth | FCA

industry's favour. In other words, more of the risks and costs of misselling, the selling of unsuitable products, and other market failures will be transferred to consumers. We explain why, below.

**Streamlining the rules will not reduce costs, or change firms' 'risk appetite' but there is a risk of consumer protection being weakened**

The FCA wants to see if it can streamline the Handbook and instead rely more on high level rules, while ensuring it continues to support and protect consumers. It says that reducing the complexity of the FCA's rulebook could '*lower costs for firms, encourage innovation and help support the risk appetite needed to support growth, ultimately boosting international competitiveness and the economy over the long-term*.' There are also claims that this initiative and others like the Advice/ Guidance Boundary Review and Consumer Credit Act review could help promote financial inclusion and financial resilience by reducing supply chain costs and changing risk appetites.

But, we do not think the FCA has not demonstrated in the Call for Input document how this initiative might promote genuinely socially useful innovation, or promote financial inclusion whilst maintaining existing standards of consumer protection.

To understand why this initiative is unlikely to significantly reduce costs or risk appetites – and why there is a threat to consumer protection standards - it is helpful to remind ourselves what regulation sets out to do and where the main regulatory costs arise for industry.

Financial regulation provides the social licence for firms to operate in a market by codifying what society, through Parliament and government, expects of regulators and regulated markets and firms. These expectations are enshrined in statutory objectives set out in legislation. This framework determines which financial activities, firms, and products should be regulated and the objectives, powers, and duties of the regulators.

The FCA has a range of powers and duties to try to ensure compliance with the regulations and take enforcement action against firms who do not comply. The FCA Handbook and other material contains principles, rules, and guidance which sets out the regulators' interpretation of those objectives and codifies in varying levels of detail what the regulator expects of firms.

Firms are then expected to 'internalise' or 'operationalise' the expectations set out in legislation, the Handbook, and other material by setting up systems and processes, and employing legal, risk and compliance specialists to: i. comply with the intention of regulation and the FCA's rules; and ii. reduce the risk of having to pay redress for misselling and treating consumers unfairly.

This is critical. The main costs associated with regulation do not arise from firms having to read a complex rule book. They come from firms internalising and operationalising regulatory expectations and managing and mitigating redress risks.

Regulation could indeed be based on high level principles leaving firms significant discretion on how to interpret those principles. Sadly, in financial services, firms could not be trusted - or could not trust themselves - to responsibly interpret and apply high level regulatory principles. Over the years, the industry has had to be told in ever increasing detail by the regulator what was expected of them with the result that the current Handbook and guidance is now very detailed.

The FCA says it intends to continue to protect consumers, which is welcome. Indeed, the Consumer Duty implies higher expectations for firms. But, the important point to note is that, even if we had a system based on high level principles rather than principles and detailed rules, firms would still need to internalise and operationalise these expectations and have effective systems and processes in place to ensure consumers are treated fairly and are sold appropriate products and services.

If consumer protection standards are maintained (and the FCA continues to enforce against these high standards), streamlining is not going to materially reduce firms need to internalise and operationalise compliance and risk management systems to meet regulatory expectations.

Nor is streamlining the rules likely to have a noticeable effect on the risk appetite of firms. Firms would only be willing to increase their risk appetite, develop more risky business models, and sell more risky financial products if they are confident they are less likely to face redress claims in the event of those products being unsuitable for consumers. As mentioned, to change firms' behaviours, a greater share of the risk and costs of misselling and other forms of consumer detriment and market failure would have to be transferred to consumers.

We think the industry knows fine well that streamlining the rule book *per se* is not going to noticeably reduce costs or change risk appetites. So, this Call for Input initiative, along with the Advice/ Guidance Boundary and Consumer Credit Act reviews, creates opportunities for financial services lobbies to push for a weakening of overall consumer protection standards.

This would reduce costs for the industry in two ways. It reduces the scope for firms to be sanctioned by the FCA or having to pay redress to consumers for misselling and other wrongdoings. And firms would have to spend less resource ensuring compliance with relevant standards. If something isn't prohibited then, by definition, they don't have to worry about demonstrating compliance.

Weakening standards would allow less scrupulous firms to sell higher quantities of poor value, unsuitable products (eg. more subprime loans), or higher risk 'innovative' products (eg. high risk, higher cost investment products) without worrying about being sanctioned or paying redress. If this happens, well-intentioned firms would be pressured by shareholders/ owners to follow suit or else lose market share.

**Streamlining the rule book is unlikely to have a material impact on promoting inclusion, socially useful innovation, or supporting inclusive economic growth**

We do not expect that streamlining the rules *per se* would: encourage financial services firms to change their business strategies to target hard-to-reach/ underserved consumers; and help promote financial inclusion and long term financial security.

As mentioned, if consumer protection standards are maintained, we do not envisage regulatory and compliance costs being materially reduced. So, streamlining the rule book is not going to improve the economics of distribution and access. Nor will it encourage firms to change their risk appetites to target excluded or vulnerable consumer groups considered to carry a higher 'regulatory risk'.

The retail financial services industry is built on consumer segmentation and profiling. Firms seek to segment and target consumers according to profitability and risk which, coupled with the economics of distribution and access, can cause financial exclusion and discrimination. This is not a criticism, it

is just the nature of commercial market provision. The increased use of tech/ big data makes it easier to segment and profile consumers and therefore can exacerbate exclusion and discrimination. Streamlining the rules is not going to change the fundamental nature of markets. It will not stop the market segmenting and profiling consumers.

Of course, as explained above, reducing consumer protection standards might make some firms more willing to target excluded or vulnerable consumers hitherto considered to be too high a regulatory risk. But, this would not be a price worth paying. We have illustrated this with three examples where exclusion or underprovision is a real issue: access to credit, the so called financial 'advice gap', and access to affordable insurance – see Annex I.

Moreover, it is not clear how reducing the complexity of the rule book *per se* will encourage innovation or support the 'risk appetite needed to support growth'. That implies that the effect of regulation in its current state (which makes firms take reasonable care before selling products) has actually held back economically and socially useful innovation and prevented appropriate risk taking.

Looking back over the years, we cannot think of any examples of genuinely economically and socially innovation that could and should have come to market but was prevented by regulation. But, there are many examples of so called 'innovation' that got to market and where fierce competition caused huge harm to consumers because policymakers and regulators failed to adopt a precautionary approach to preventing consumer harm.

**FIC recommendations**

Weakening consumer protection would not be a sensible solution to encouraging risk taking, tackling exclusion, or promoting socially useful innovation. We do not know yet what the industry will propose. But, we urge the FCA to:

- publish a full list of proposals submitted by the industry;
- publish an assessment of the proposals on consumer protection standards; and
- with regards to revising how information is disclosed, conduct research with consumers to gauge understanding.

Competition and financial innovation have not been very effective at producing good consumer outcomes in retail financial services. Whereas, as we explain in our response to Q4, robust regulatory interventions have driven major improvements in retail markets. Moving to a more high-level rules based approach, and allowing firms more discretion on how to demonstrate compliance with regulatory expectations, could make it more difficult for the FCA to monitor and supervise market behaviours. Therefore, any proposed changes should be assessed for the potential impact on the FCA's ability to exercise its supervisory and enforcement functions.

We urge the FCA to create an independent advisory committee comprised of consumer representatives to scrutinise and advise the FCA on the potential impact of any proposals.

**Question 2: Is there a lack of clarity on how requirements under the Duty and other FCA rules interact? Please tell us where this issue arises and your views on how it could be addressed. For example, would guidance on the interaction be helpful?**

We have no comment on this question except to say that in our experience it has been firms which have historically demanded more detailed rules and additional guidance to help them understand the intentions behind regulation and high level rules. We suspect that if there was a move towards high level rules, many firms would soon ask for the FCA to provide more detail on what is expected of them in high level rules.

**Question 3: Are there other areas in our rules or guidance, beyond those with an overlap with the Duty, where we should consider simplification or removal? Please tell us: a. which rules or guidance (e.g. Handbook chapters, or non-Handbook guidance) we should review, and why; b. your thinking on the likely benefits including, for example, any estimate on compliance cost savings; and c. what the impact could be on consumer protection, or other relevant considerations**

See above answer to Question 1.

**Question 4: Do you agree that work towards simplifying our retail conduct rules can help us meet all our objectives, including the secondary objective? Please explain why or why not.**

We note that the FCA did not ask consumer advocates to make proposals on how to make the Consumer Duty more effective. That could have enhanced the ability of the FCA to meet its consumer protection and competition objectives.

It is not possible to say with any degree of certainty at this stage what the impact will be on the FCA's primary consumer protection and competition objectives, or secondary growth and competitiveness objective, until we see which particular proposals the industry makes and how the FCA responds to those proposals. But, we take the view that, if the FCA does restrict its response to streamlining or simplifying conduct rules, this is unlikely to make a significant difference to those objectives.

There is one area where the FCA's proposed approach could have a negative impact on the objectives. The FCA talks about enabling '*greater innovation in disclosure that benefits retail consumers and firms*'.[8] It is not clear what the FCA means by 'innovation in disclosure'. But, we presume that the FCA would allow firms more discretion on how they disclose critical product and service information to consumers. This is likely to lead to firms adopting different approaches to disclosure, which would encourage confusion marketing and actually make it harder for consumers to compare different offers. So, even if the FCA intends to maintain the overall effect of regulation, this could weaken consumer protection and further undermine already weak competition in the market – see below.

[8] See SRF example described in para 2.14

However, to reiterate, our main concern is not the act of streamlining the rules. Rather, it is the potential impact of this Call for Input on consumer protection standards. Our engagement with the industry tells us that firms recognise that if consumer protection standards are maintained, streamlining the rules *per se* will not much change its cost base or increase its risk appetite. So, there is an obvious risk the industry will push for reductions in consumer protection standards by transferring some of the risk of misselling and other market failures to consumers.

This might make the industry appear more competitive in the short term (if 'competitive' is taken to mean regulatory costs for the industry being reduced). But, this would undermine the FCA's consumer protection and competition objectives, and the competitiveness objective in the long term. Why do we say this?

The current state of regulation, and specifically the rules in the Handbook, is not the main cause of ineffective competition in retail financial services or market behaviours and structures which produce poor outcomes. It follows that streamlining or simplifying the rules *per se* is unlikely to improve competition in retail financial services.

Or, more precisely, it is unlikely to improve consumer *outcomes*. Competition is a means to an end. Unlike other consumer sectors, competition has never been particularly effective in retail financial services as a driver of good consumer outcomes. Nor is it likely to be.

The specific dynamics of the financial services market, the complexity of financial products and services, and low levels of consumer financial capability (which show little sign of improvement) means that competition in financial services can actually create poor consumer outcomes.

The commercial imperative for for-profit firms is to win market share and maximise profitability for shareholders/ owners/ executives by efficiently identifying and extracting value from the most profitable consumers. Most profitable in this case isn't always those consumers with higher disposable incomes, it can be the most vulnerable consumers – which is why consumer protection is needed.

Firms in the market for retail financial services, for the most part, do not compete on value or fair treatment of customers. Consumer sovereignty in retail financial services is weak meaning adverse firm behaviours and practices are not held in check by consumer pressure. So, the fiercer the competition, the worse the outcomes can be for consumers - unless constrained by regulation. This is not a criticism, just a reflection of the nature of the market.

If consumer protection standards are weakened, no doubt we would see more market activity, spurious innovation and product launches, targeting of consumers and so on. This would certainly create the illusion of greater competition. But, this would enable misselling or selling of poor value, toxic. or socially useless products. It would not create better outcomes which, after all, what matters. Ultimately, it would undermine trust and confidence in products and services so harming long term industry competitiveness.

The FCA has not demonstrated why it thinks this initiative would improve consumer outcomes. In contrast, robust direct regulatory interventions have produced good consumer outcomes.

Regulation has driven up conduct standards, driven out many of the worst practices, and enhanced value.

It must be acknowledged that we have seen significant improvements in the conduct of business standards in retail financial services. Consumer scandals still happen as the current car finance scandal and recent defined benefit pension transfer misselling scandal show. But, we do not see the same number of regular large scale systemic misselling scandals we saw in the past.

Major regulatory interventions drove significant improvements in quality and value in the investment funds and financial advice markets (the RDR) and drove out the worst excesses of the legal payday lending/ subprime lending market (the payday lending price cap and FCA's regulation of consumer credit). The overdraft market has been significantly improved (although it still doesn't work well enough for low income/ 'high risk' consumers.

There is much progress to defend and potential future harm to protect against. So, we would urge the FCA to consider carefully how this initiative might affect the regulator's ability to execute its monitoring, supervisory, and enforcement functions rather than just focus on assessing how this might affect firms' behaviours.

We are concerned that if the FCA moves from a system, where it lays down detailed rules and guidance and expects all firms to comply, to one where it allows individual firms to determine their own way of complying, FCA supervisory teams could struggle to ensure a consistent approach to monitoring and supervision. This could make the FCA's job even more challenging. Encouraging 'innovation in disclosure' is a case in point, see above.

**Question 5: In which circumstances do you think it is appropriate to rely on: a. high-level rules under the Consumer Duty b. more detailed rules c. a hybrid approach with both high-level and detailed rules?**

The FCA has helpfully provided a number of examples but without more specific details it is difficult to respond definitively or constructively to this question. But, we take the view that a hybrid approach would probably be the best approach. We could envisage the Handbook and other material being restructured so that we have a clear three tier structure with:

- High level outcomes, principles, and rules which would set out clearly the FCA's interpretation of what is intended in FSMA legislation and the FCA's expectations set out in the Consumer Duty
- Core operating principles and rules which apply to all categories of regulated financial activities
- Specific rules and guidance applying to each of the categories of regulated financial activities which could combine the relevant COBS and relevant elements of the PROD Sourcebook. This could be tailored to account for the nature and causes of specific harms and detriment evident in the particular market.

However, this probably involves a much more significant restructuring of the Handbook than currently envisaged by the FCA.

We have some other comments to make. The Handbook is very detailed and complex. But, as explained above, much of this complexity has been driven by the industry itself asking for further clarification on what is intended by high level rules and principles.

The FCA says in para 4.4 that the flexibility of high-level requirements may be better able to address complexity, help promote innovation, and better deal with change in the market. But, it doesn't explain how or why this would be the case. As we explain above, we cannot think of examples of genuinely economically and socially useful financial or fintech innovation that has been prevented by the current approach to regulation.

If new drivers of harm do emerge, we struggle to see how firms will be comfortable relying on high-level requirements. If experience is anything to go by, we would expect that very soon firms would be yet again demanding clarification from the regulator on how to respond to the emerging harm.

As regards to dealing with change, even if market structures, technologies, and products change we presume the standards expected of firms by the FCA and consumer rights to redress will not. Again, the history of regulation suggests that firms would prefer the comfort of detail.

The FCA includes the example of *Event-driven disclosure in the mortgage sector.* With regards to the provision of critical information to borrowers, the FCA suggests more reliance could be placed on the Consumer Duty's cross-cutting rules and consumer understanding requirements. The FCA says that this may give firms greater flexibility to meet the needs of customers and deliver good outcomes. This could indeed give firms more flexibility. This may help some firms struggling to respond during times of crisis. But, if the FCA intends that this would apply to all situations like this in future, it is easy to imagine where this might take us. Over time, we could end up with firms taking very different approaches to disclosure. As mentioned above, inconsistencies could make the FCA's supervision of treating borrowers fairly more difficult.

**Question 6: What do you see as the main costs and benefits of making changes to the FCA Handbook by simplifying or removing detailed expectations of firms?**

See above. If the Handbook can be streamlined or simplified without compromising consumer protection standards this would be a positive development. But, if current standards of consumer protection are to be maintained, we do not see simplifying or streamlining the Handbook *per se* making any significant differences to industry costs or risk appetites.

Regulatory costs for the most part do not arise from the complexity of the Handbook. The costs mainly arise from the necessary establishment and operation of systems and employment of compliance and risk professionals to ensure compliance with regulatory expectations.

The current state of regulation does not hinder socially useful financial or fintech innovation, inclusion, or competition that works for consumers. So, we do not see how streamlining or simplifying the rules *per se* will help pursue those goals.

We think the industry recognises that streamlining or simplifying rules will not make a material difference to end-to-end regulatory costs or risk appetites. What would make a difference is

reducing consumer protection standards and rights to redress as this would transfer risk and costs of misselling and market failure to consumers. But, the costs of that would outweigh potential benefits.

**Question 7: Where do you see high-level or detailed expectations having differing costs or benefits for different types or sizes of firm?**

No comment.

**This marks the end of our submission.**
**October 2024**

## Annex I: Three case studies

We have included three case studies to illustrate why streamlining the rule book *per se* is unlikely to make much, if any, difference to financial inclusion and effective competition that generates good consumer outcomes.

### The causes of financial exclusion

The primary causes of financial exclusion and discrimination are: poverty and the nature of markets. Obviously, the FCA cannot address poverty-related causes of exclusion. But, it can address market factors that cause or contribute to exclusion and discrimination.

The critical point to note is that retail financial services is built on consumer segmentation and profiling – that is, identifying and sorting consumers into high risk/ low profit and low risk/ high profit groups (and points in between).

The commercial imperative for for-profit firms is to maximise profitability for shareholders/ owners/ executives by efficiently identifying and extracting value from the most profitable consumers. The growth in the use of AI/ tech/ big data makes this process of profiling and value extraction even more efficient.

For-profit firms are not charities, it's all about the bottom line. This is not a criticism. It is just how markets work. The most profitable consumers aren't always the most well-off consumers. It can also be those consumers who are the most vulnerable to this value extraction. It is the job of regulators to constrain markets so that consumers are not exploited.

Financial inclusion doesn't just mean consumers having access to products and services. It isn't just a numbers game. Consumers need access to products and services that are fair, affordable, fit for purpose, safe and trustworthy provided by efficient firms that operate with integrity.

Commercial firms will, of course, sell to anyone if the price is right – *for them*. But, products and services must be provided on terms that make sense for *both* providers and consumers. Products and services must enhance consumer welfare, and be economically and socially useful. In certain cases, consumers were sold products that actually harmed their wellbeing.

Payday lending is a case in point, see below. In this case, putting rules in place to prevent groups of consumers being targeted by subprime lenders, to actually stop consumers having these products, was a good outcome as it improved consumer welfare.

There is more general principle. Across a range of product sectors, in a properly regulated market, large numbers of consumers are just not commercially attractive enough for for-profit firms to want to serve. Streamlining the rules are unlikely to make much difference to the economic viability of excluded consumers if consumer protection standards are maintained.

It would be possible to make underserved consumers commercially attractive again by reducing the costs of providing products and services to them. And reducing the levels of consumer protection (which would reduce firms compliance costs and potential redress costs) would change the economics of targeting excluded households.

Would that tackle exclusion and discrimination? It is unlikely. Some parts of the market would use it to resume targeting vulnerable consumers with poor value, welfare-damaging products. This might make it look as if more consumers are being included. But, as explained, inclusion is more than just a question of numbers of consumers with products. It is about consumers having access to products and services which enhance their financial well-being.

Other parts of the market would use the reduction in consumer protection to target better off consumers with toxic products knowing the risk of facing redress bills would be reduced, not use the opportunity to target lower income consumers.

Let's look at the three case studies.

**Access to affordable credit**

Access to affordable credit in the appropriate circumstances is a good thing. Expanding access to affordable and suitable credit for underserved consumers is a priority for the FIC and other civil society organisations.

The legal subprime consumer credit market has shrunk considerably since the introduction of the price cap on payday lending and consumer credit being regulated by the FCA. The fact that we saw a reduction in the numbers of consumers holding those products is a good thing. Pre regulation and price cap, the payday lending business model was profitable only because firms were able to sell vulnerable consumers inappropriate products. Once firms were required to treat consumers fairly, the business model no longer worked.

Streamlining the Handbook is not going to change the willingness of regulated for-profit credit firms to sell credit to a lower income/ higher risk consumers. The only way that firms would be willing to resume selling credit to lower income/ higher risk consumers is if the subprime lending business model became commercially attractive again. It would be possible to rebuild the subprime lending market by weakening consumer protection so that the risk of falling foul of the FCA and having to pay redress for selling unsuitable products was reduced. Yet that would just encourage the selling of unsuitable credit again. Attempting to solve one problem by (re) creating another would not be advisable.

Claims have been made that robust consumer protection has *caused* an increase in illegal lending. But, there is no evidence that this is the case. If there has been a growth in illegal lending (and we cannot say with certainty how much illegal loan sharking has grown due to the lack of consistent longitudinal tracking studies), it is just as likely to have been caused by the impact of austerity and ongoing cost of living crisis experienced by households on the lowest incomes. More pertinently, streamlining the rules is not going to persuade regulated lenders to all-of-a-sudden start lending to people who are using illegal lending.

Given that streamlining the rules will not change the economics of distribution or risk appetites of lenders, we are concerned that parts of the consumer credit lobby will use this Call for Input and review of the Consumer Credit Act to push for weakening of consumer protection standards.

This will not expand access to affordable and suitable credit. There are better alternatives including: supporting the non-profit community lending sector; expanding the use of workplace payroll savings schemes which support credit union ability to provide loans; allowing debt advice charities to refer consumers to non-profit community lenders; and improving the way information is used in credit risk assessments to build a bridge back to financial inclusion as proposed by Registry Trust.[9]

**The 'advice gap'**

The same arguments are being deployed with regards to the so-called 'advice gap'. The claim is that, following the implementation of the Retail Distribution Review (RDR), regulated firms can now only provide financial advice to wealthier consumers; and are prevented from persuading people with modest assets to invest more of their savings, currently held on deposit in low interest rate accounts, into investment products which would generate a higher return.

To address this, finance lobbies argue that the 'advice/ guidance boundary' should be redrawn to allow firms to target consumers to persuade them to invest in higher return products without being deemed to have given financial advice as currently defined in the regulations. They say this would change firms' risk appetites which would help firms fulfil their social obligations by closing this so called 'advice gap' and help the UK economy by steering more investment into UK companies.

We believe these arguments are disingenuous. The RDR has delivered real improvements in the advice market and driven down investment fund costs. The RDR has not caused an advice gap. What it has done is expose the fact that large groups of consumers were not actually economically viable in a well-regulated market.

Redrawing the boundary wouldn't just be a harmless stroke of the regulatory pen which magically turns unprofitable consumers into profitable ones. Redrawing the boundary would reduce the risk that firms could be held account and having to pay redress for consumers being sold unsuitable, higher risk, more costly investment products. It would involve a reduction in consumer protection standards.

If there is a reduction in consumer protection standards, we doubt firms would use this opportunity to target consumers with modest assets. We think the real goal is to change the boundary so that firms can 'up-sell' higher risk, more expensive products to better-off consumers safe in the knowledge that if things go wrong firms will be less likely to be liable for redress. Again, we think the goal is to transfer the risks and costs of misselling from firms to consumers in the target markets.

We are concerned that consumer protection in the investment fund and financial advice market could be weakened via the advice/ guidance boundary review and this Call for Input.

**Access to insurance**

Access to insurance is the 'Cinderella' of financial exclusion and discrimination. It does not get the same coverage as access to credit or building financial resilience and security. More needs to be done to tackle this aspect of exclusion and discrimination.

[9] See Registry Trust The Data That Matters

But, would streamlining the rules and guidance help? Again, it is hard to see how the Call for Input and streamlining rules and guidance is going to make a difference to insurance exclusion and discrimination. As explained above, financial services are built on profiling and segmentation. None more so than insurance. Streamlining the rule book is not going to change the fundamental nature of the insurance business model – that is, if insurers consider consumers to be a higher risk/ unprofitable they will be charged a higher price or excluded altogether from insurance markets.

However, even if this current streamlining initiative doesn't change insurers' attitudes to excluded consumers, weakening consumer protection standards would, of course, reduce the risk of having to pay redress if firms missell or treat unfairly consumers in the existing target market.

We are concerned that insurance trade bodies might use this Call for Input to propose weakening of consumer protection standards badged as well-meaning attempts to make markets more 'inclusive' but whose real purpose is to reduce ongoing compliance and redress costs for insurers.

**About The Financial Inclusion Centre**

The Financial Inclusion Centre (FIC) is an independent, not-for-profit policy and research group (www.inclusioncentre.org.uk). The Centre's mission is to promote a financial system and financial markets that work for society. The Centre works at two main levels:

**Promoting system level change**

Research and policy development to promote sustainable, resilient, economically and socially useful financial markets that: benefit the environment; encourage responsible corporate behaviours and create a positive social impact; and efficiently allocate long term financial resources to the real economy.

**Ensuring households' core financial services needs are met**

Promoting fair and inclusive, efficient and competitive, well-governed and accountable, properly regulated financial markets and services that meet households' core financial needs. We do this by undertaking research into the causes of market failure in the sector, formulating policies to address that market failure, developing alternative solutions where the market cannot deliver, and campaigning for market reform. We focus on households who are excluded from, face discrimination in, or are underserved by financial markets and services.

For further information please contact:

Mick McAteer
Co-Director
Financial Inclusion Centre
mick.mcateer@inclusioncentre.org.uk, or mickmcateer92@gmail.com