



## *The Money Charity Response - HMT Financial Services Future Regulatory Framework Review (October 2019)*

The Money Charity is a financial capability charity whose vision is to empower people across the UK to build the skills, knowledge, attitudes and behaviours to make the most of their money throughout their lives.<sup>1</sup>

We welcome the opportunity to respond to HMT's Call for Evidence in relation to its financial services regulatory framework review.

In this response, we set out our Key Points, make some overall comments on the issue then answer the questions posed in the Call for Evidence from the point of view of the performance of the system in achieving its consumer protection objectives.

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<sup>1</sup> See box on back page.

## Key Points

1. We support the goal of regulatory efficiency, but this goal should not be used to dilute or delay consumer protection.
2. Although consumer protection is one of the goals of the Financial Services and Markets Act 2000 (FSMA), examples of consumer harm continue to emerge on a regular basis.
3. These examples are not confined to exceptional cases but involve major financial firms, large markets and millions of consumers.
4. Harm is often caused to consumers in vulnerable situations.
5. Parliamentary bodies such as the House of Lords Select Committee on Financial Exclusion and the Treasury Select Committee have expressed frustration with the continued occurrence of consumer harm in financial markets and have called for further regulatory reform, such as the introduction of a Duty of Care.
6. The feeling that regulatory interventions are onerous may arise from the fact that firms have not moved sufficiently at a fundamental level to avoid the harms which regulators regulate against. If business models were corrected at a more fundamental level, this would reduce ad hoc intervention and lead to an overall more efficient system.
7. HMT should initiate changes to the regulatory framework to strengthen the foundation for consumer protection, by:
  - Amending FSMA so that avoidance of consumer harm becomes the central and fundamental duty of financial service firms.
  - Introducing a Duty of Care requiring firms to avoid reasonably foreseeable consumer harm and to act in customers' best interests.
  - Amending the SM&CR so that individual senior managers who make decisions leading to consumer harm face sanction and penalty.

# Overall Comments

## Interpretation of the questions asked

The questions asked<sup>2</sup> in the HMT Call for Evidence focus on the cumulative impact of financial market regulations emanating from the various financial market regulators (FCA, PSR, FPC, PRA and EU). One of the sub-questions is:

“How UK bodies balance the benefits to consumers of financial services (both individual and businesses) of timely regulatory action against the impact on firms of meeting potentially challenging timeframes on requirements.” (Q1.a, p12)

We interpret this to mean that some firms and perhaps trade bodies have raised concerns with HMT that the requirements for consumer protection are in some way(s) too onerous. One possible outcome of the review would be for consumer protection to be relaxed or for the timetable for consumer protection to be extended.

This concerns us as one of our core policy calls<sup>3</sup> is for financial regulation that helps consumers behave in financially capable ways. Any weakening or delay in necessary regulation would inevitably lead to less satisfactory outcomes for individual consumers and a lower level of financial capability in the UK overall, conflicting with other aspects of government policy such as the recent formation of the Money and Pensions Service.

## FCA findings of consumer harm

In recent years the FCA has been active, as it should be, in examining financial markets in which there is evidence of consumer harm, for example the high cost credit market, overdrafts, credit cards, DB pension transfers and other markets and products affecting, in one way or another, most of the UK population. We have welcomed these FCA interventions as they have occurred.<sup>4</sup>

These interventions, and the market studies that preceded them, have revealed large-scale consumer harm, affecting millions of UK consumers including, and often especially, those in vulnerable situations. For example:

In relation to **overdrafts**, the FCA found more than 50% of firms' unarranged overdraft fees came from just 1.5% of customers, many of whom were people in vulnerable

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<sup>2</sup> Call for Evidence, pages 12-13.

<sup>3</sup> See: <https://themoneycharity.org.uk/media/The-Money-Charity-Policy-Paper-Financial-Regulation.pdf>

<sup>4</sup> <https://themoneycharity.org.uk/work/policy/consultation-responses/>

situations. In some cases, overdraft fees were found to be more than 10 times as high as fees for payday loans.<sup>5</sup>

In relation to **credit cards**, the FCA found that 2.1 million people were in persistent credit card debt and 1.6 million were making systematic minimum payments.<sup>6</sup> These consumers were being allowed, in effect, to borrow long at short-term interest rates, contrary to the FCA's rules on responsible lending and affordability assessment. As a result of this, FCA introduced new rules on the management of persistent credit card debt, which will begin to bite in 2020.

In relation to **buy-now-pay-later**, the FCA found that around 50% of consumers did not repay the full balance before the end of the promotional period and that many firms charged interest not only on the unpaid balance but on the part of the balance that had been repaid.<sup>7</sup> The FCA found defects in the way information was presented to consumers, making it harder for consumers to understand the terms of the product they were buying.

In relation to **rent-to-own**, the FCA found that firms were charging excessive prices to a vulnerable customer base, many of whom did not have the levels of financial capability to understand the relationship between weekly repayments, term lengths and interest costs.<sup>8</sup> The FCA found that typically RTO prices were three times the median retail price and could be four or five times the median retail price.

In relation to **defined benefit pension transfer advice**, the FCA found that “69% of consumers are advised to transfer despite our view that most customers would be best advised not to transfer. We estimate that the harm created by unsuitable DB transfer advice is up to £2 billion each year.”<sup>9</sup>

In relation to **general insurance pricing** (subject to a super-complaint by Citizens Advice to the Competition and Markets Authority) the FCA found that six million policy holders paid excessive prices in 2018, costing them an extra £1.2 billion. This is because of “price walking” and the loyalty penalty, otherwise known as price discrimination or (from the firm's point of view) “price optimisation”. The FCA found that one third of affected customers were in vulnerable situations and that “firms engage in a range of practices that could make it more difficult for customers to make informed decisions and could raise barriers to switching.”<sup>10</sup>

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<sup>5</sup> FCA, High cost credit review: overdrafts consultation paper and policy statement, CP18/42, December 2018, p3.

<sup>6</sup> FCA, Credit card market study - final findings report, MS14/6.3, p29.

<sup>7</sup> FCA, High-cost credit review, CP18/43, Chapter 4.

<sup>8</sup> FCA, Rent-to-own and alternatives to high-cost credit, CP18/35, page 4.

<sup>9</sup> FCA, Pension transfer advice: contingent charging and other proposed changes, CP19/25, page 3.

<sup>10</sup> FCA, General insurance pricing practices – interim report, MS18/1.2, page 3.

It may be argued that the fact that the FCA is making these studies and interventions is evidence that the regulatory framework is working well. To an extent we agree with this. Things would be far worse without the FCA's interventions. However, the pervasive nature of the harm revealed by the FCA's market studies suggests a different conclusion: that at some fundamental level there is still a misalignment between the financial services sector and the interests of consumers, despite FSMA having consumer protection as one of its three statutory objectives.

As HMT will be aware, the consumer harm identified by the FCA is not being perpetrated by a few rogue traders but by mainstream providers, including many of the big household names in the banking, insurance and related sectors. This suggests there is a systemic problem to be addressed, particularly as the evidence shows the vulnerable are at risk.

### **Parliamentary concern**

Concern about this situation is widespread. Charities and consumer groups have made many submissions to the FCA and other regulators about consumer harm in the financial sector and its potential remedies. Parliamentary committees such as the House of Lords Select Committee on Financial Exclusion and the Treasury Select Committee have heard evidence of harm and made recommendations for reform of financial regulatory practice, including better enforcement of the Equality Act. For example, in May 2019, the Treasury Select Committee concluded that:

“All retail financial services, no matter which sector of the industry they operate in, should be acting in their customers' best interest at all times. If the FCA is unable to enforce such behavior in firms under its current rule book and principles, the Committee would support a legal duty of care, analogous to that in the legal industry, creating a legal obligation for firms to act in their customer's best interests.”<sup>11</sup>

### **Information asymmetry and financial capability**

As a financial capability charity, we have a particular concern about the link between consumer harm and information asymmetry between firms and consumers, which firms exploit through complex language, non-transparent product terms and exploitation of consumer biases. To take a mainstream example: the setting of the minimum credit card monthly payment to be interest and charges plus 1% of the outstanding balance. The minimum payment acts as an anchor and the minimum payment formula encourages credit card users to remain in persistent debt. There is a simple remedy to

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<sup>11</sup> Treasury Select Committee, May 2019, *Report on consumers' access to financial services*, page 59.

this problem (a slightly higher minimum payment with a £ ratchet) which the industry has chosen not to implement.

For most consumers, the industry sells products that are complex and often difficult to understand, so it must fall to financial firms to take responsibility for the avoidance of foreseeable consumer harm.

### **The Senior Manager and Certification Regime**

A further concern is the apparent ineffectiveness of the Senior Manager and Certification Regime at preventing practices that lead to consumer harm. Rule 4 of the SM&CR states that: “You must pay due regard to the interests of customers and treat them fairly.”<sup>12</sup>

Given the widespread consumer harm identified in FCA market studies, this rule must have been broken multiple times by many senior managers, for example all senior managers involved in general insurance pricing and overdraft pricing, yet in most cases senior managers have escaped censure or penalty in relation to the FCA harm findings.

In 2019, the FCA conducted a stock-take of the SM&CR and found, inter alia, that:<sup>13</sup>

- Firms have not always sufficiently tailored their conduct rules training to staff’s job roles.
- There was insufficient evidence to be confident that firms have clearly mapped the conduct rules to their values.
- Many firms were often unable to explain what a conduct breach looked like in the context of their business.

In its Call for Evidence, HMT emphasises the impact of the crash of 2008 on financial market regulation. However, in our view, the culture of impunity that was a feature of the crash and its aftermath continues to be the dominant cultural mode of the industry. With few exceptions, firms and individual managers do not face sanction, even when breaches of the spirit and letter of FCA rules inflict harm on many consumers over long periods of time.

### **What needs to change?**

The HMT review provides an opportunity to consider how the regulatory framework can be reformed to better embed consumer interests in the business models of the industry.

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<sup>12</sup> <https://www.handbook.fca.org.uk/handbook/COCON/4/1.html>

<sup>13</sup> <https://www.fca.org.uk/publications/multi-firm-reviews/senior-managers-and-certification-regime-banking-stocktake-report>

If firms and their trade associations are concerned about what they see as an onerous regulatory burden, it may be because the industry is still habitually causing consumer harm, necessitating product-by-product intervention by the FCA and other regulators.

There is an interesting question here about regulatory efficiency, which we think HMT is right to raise. If interventions take place sequentially and in a somewhat ad hoc way, it must appear to firms that they are continually being forced to change their systems and update their software, with all the costs that this involves. But if consumer interests were embedded at a fundamental level, it would not be necessary to make ad hoc changes and company systems would then be able to proceed more efficiently. FCA enforcement action could focus on rogues and outliers, rather than on reforming the approach of the entire industry.

In our view, there are three key changes that HMT could initiate:

1. Amending FSMA so that avoidance of consumer harm becomes the central and fundamental duty of financial service firms.
2. Introducing a Duty of Care requiring firms to avoid reasonably foreseeable consumer harm and to act in customers' best interests.
3. Amending the SM&CR so that individual senior managers who make decisions leading to consumer harm actually face sanction and penalty. In our view, a relatively few cases of sanction for mainstream breaches of FCA rules would provide significant "encouragement"<sup>14</sup> for all senior managers to design products that avoid consumer harm.

## **Answers to Call for Evidence questions**

For us, Question 1 is the most relevant:

### **Q1(a): How UK bodies balance the benefits to consumers of financial services (both individual and businesses) of timely regulatory action against the impact on firms of meeting potentially challenging timeframes on requirements?**

As indicated in our response above, we think that the level of regulatory intervention arises from consumer interests not being sufficiently grounded in the fundamental approach of the financial service industry. This forces the FCA to make product-by-product interventions, leading to sequential updates of product design, customer service and IT systems, which may coincide unintentionally with the interventions of other regulators.

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<sup>14</sup> Voltaire, *Candide*, the reference to British admirals.

The industry needs to respond by embedding customer interests from the ground up, including in the way it presents information, to assist an improvement in financial capability and consumer outcomes. To ensure this happens, HMT should initiate:

1. Amending FSMA so that avoidance of consumer harm becomes the central and fundamental duty of financial service firms.
2. Introducing a Duty of Care requiring firms to avoid reasonably foreseeable consumer harm and to act in customers' best interests.
3. Amending the SM&CR so that individual senior managers who make decisions leading to consumer harm face sanction and penalty.

**Q1(b): How UK bodies understand and assess the overall impact of simultaneous regulatory interventions on firms, particularly in the way these are sequenced and how they consider the wider regulatory landscape?**

As indicated above, we think the best way of reducing the impact of simultaneous regulatory interventions is by firms taking pre-emptive action to embed the avoidance of consumer harm in product design, customer service and supporting IT systems.

**Q1(c): Whether UK bodies request the right amount of information from firms as part of the policy-making process, and whether these processes provide an adequate opportunity for firms to highlight the impact of proposed changes?**

One aspect of FCA market studies is the collection of large amounts of customer-level data from firms. For example, the data collected as part of the overdrafts, credit card and insurance market studies. These datasets have enabled the FCA to conduct illuminating analyses of the various markets, bringing into the public domain patterns and behaviours that would otherwise have remained private and hidden. For example, the study of credit card payments showed the powerful anchoring effect of two numbers: the monthly total outstanding and the minimum payment. Most credit card users pay either the minimum amount or the entire outstanding balance each month. This is a classic example of a behavioural bias, the revelation of which provides a path to considering effective remedies for persistent credit card debt.

In future, as firms expand the use of Big Data in their business models, it will be even more important for the FCA to collect large datasets at the individual customer level (suitably anonymised) in order to test for biases and fairness in product access and pricing. For example, whether the algorithms used by the insurance sector produce customer offers that comply with the provisions of the Equality Act.



We would therefore be opposed to any initiative by the industry to restrict the quantity of data collected by regulators or to replace raw customer-level data with synthetic data or statistical summaries.

As a charity whose mission is to improve UK financial capability, we greatly value the data analyses carried out by the FCA. We think this view would be widely shared in the charity and consumer sector.

**The Money Charity** is the UK's financial capability charity providing education, information, advice and guidance to all.

We believe that everyone achieves financial wellbeing by managing money well. We empower people across the UK to build the skills, knowledge, attitudes and behaviours to make the most of their money throughout their lives, helping them achieve their goals and live a happier, more positive life as a result.

We do this by developing and delivering products and services which provide education, information and advice on money matters for those in the workplace, in our communities, and in education, as well as through influencing and supporting others to promote financial capability and financial wellbeing through consultancy, policy, research and media work.

We have a 'can-do' attitude, finding solutions to meet the needs of our clients, partners, funders and stakeholders.

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