



The UK Financial Services Authority's Approach to Consumer Protection

May 2010

The Consumer



- Immensely diverse needs across a huge range of products
- Needs evolve and are affected by social and technical change.

Consumers should be able to expect:

- **Choice** in a market which develops to meet needs
- **Clear information and advice**
- **Performance** - and service - which meets (reasonable) expectations
- **Complete confidence in financial institutions' solvency.**
- **Equal protection when products are 'imported' or bought across borders.**

Basic Requirements

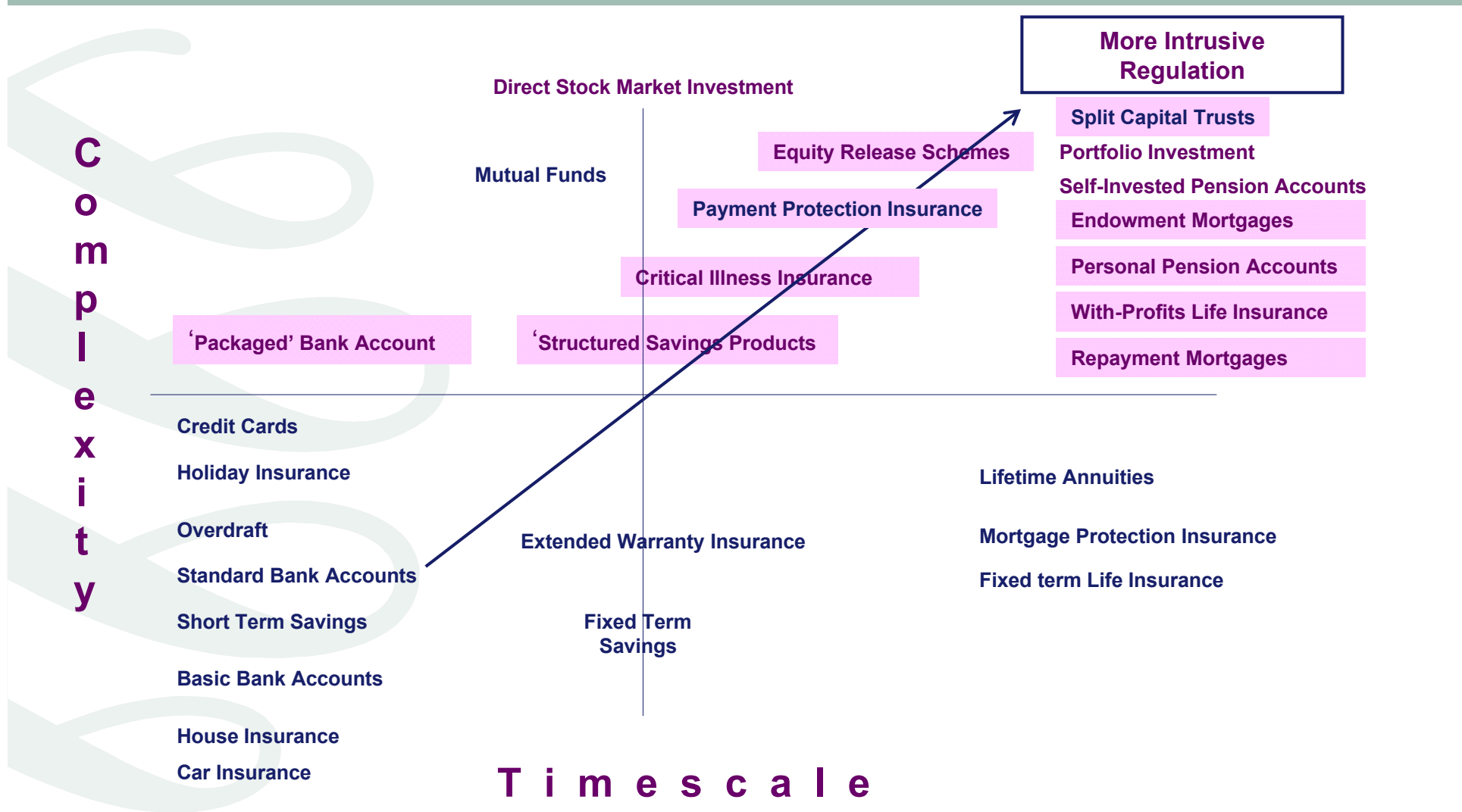
Consumers need:

- **‘Prudential’ protection** - eg against a deposit-taker going bankrupt
- **Mainstream consumer rights** - eg fair and honest advertising, effective complaints and redress procedures, clear product information, fair contract terms
- **Protection against problems which are specific to some financial services.**

Risks where:

- Many consumers may have **difficulty understanding a product** - because it is complicated, or how it works or its price is opaque
- Behavioural **biases are exploited** (eg inertia; concentrating on minor product features; naivety about risk)
- Many consumers want, need or are offered **product-specific advice** before buying but do not pay directly for this. (Not a problem in all markets.)
- The possible **financial loss** to a consumer is high
- The **product has a long life** (many consumers find balancing long term and short term decisions difficult) and is hard to exit.

Consumer Risk Matrix



Regulator Risk Matrix



Severity	Incidence L	M	H
L	Green	Green	Yellow
M	Green	Yellow	Orange
H	Yellow	Orange	Red

The FSA's Statutory Objectives



- Maintain **Market Confidence**
- Appropriate degree of **Consumer Protection**
- Reduce **Financial Crime**
- Promote **public understanding** of the financial system
- Contributing to the protection and enhancement of the UK financial system through increased **financial stability**

The right regulatory framework



- **Comprehensive work on Prudential regulation over the past 2.5 years**
 - Turner Review
 - Senior participation in international rulemaking
 - Solvency 2 Implementation
- **New approach to Markets**
 - Recognises London as pre-eminent market in Europe; world
 - Takes account of future role of ESMA
- **Conduct ?**

FSA Conduct Strategy



Overall objectives:

- **making the retail market work better for consumers**
- **avoiding actual consumer detriment ('risk crystallisation') wherever possible**
- **delivering credible deterrence and prompt and effective redress for consumers.**

This Conduct Strategy will work alongside the prudential regime to provide appropriate consumer protection and deliver better outcomes for consumers.

Conduct Strategy: Past Approach

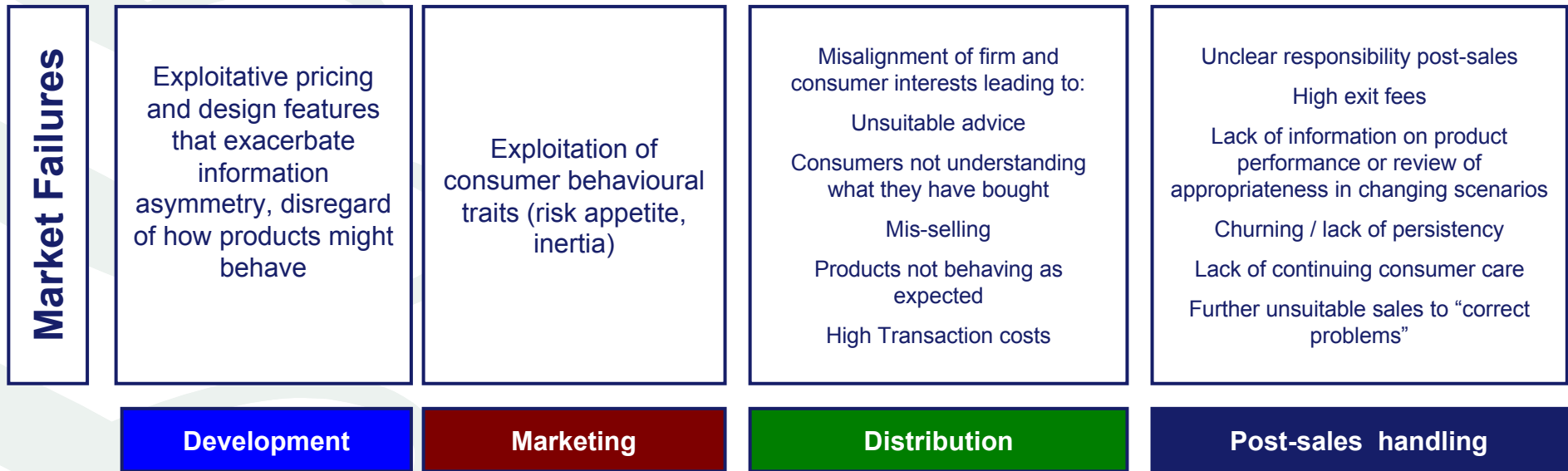


- **Traditional focus of conduct regulation (EU and UK):**
 - **What happens at the point of sale:**
 - Suitability of product for the individual consumer
 - Sales processes
 - Effective information on price, adviser status, key features, risks, etc.
 - **Dealing with problems after consumers have lost out**
 - In UK, also focus on assessing providers' **high level systems and controls** for assurance that consumers being treated fairly.
- **EU focus** traditionally on cross-border policy issues. Expect intervention on consumer protection grounds and more supervisory focus.

Limits of Past Approach



Where market failure can occur in the product life cycle



Traditional focus of FSA intervention



FSA's Conduct Strategy – a holistic approach FSA®

1. Comprehensive risk analysis and research to identify earlier the **sources and nature of conduct risks**
2. Sector-wide intervention to **change incentives** in the markets where necessary (either in a pre-emptive manner or where other interventions have failed)
3. Intervention further up the value chain, in **scrutinising products**
4. Using **intensive supervision** in firms to identify and reduce emerging conduct risks
5. More **aggressive use of enforcement** tools to create credible deterrence in firms
6. Improvement of the framework and **delivery of redress** to consumers
7. Early and effective influencing on **conduct issues at the EU level**

1. Conduct Strategy 1: Proactive risk analysis



Horizon Scanning - Standing back and looking across the retail markets to identify conduct risks 12-24 months before they cause significant consumer detriment.

Methodology

Development of scenario for how the retail financial services market may evolve over the next 2-3 years, incorporating:

- Business models analysis
- Sector trends
- Macroeconomics forecasts.
- Market research, including competitive dynamics in financial product markets
- Consumer characteristics and behavioural biases.



Identification of conduct risks that are most likely to be prevalent.

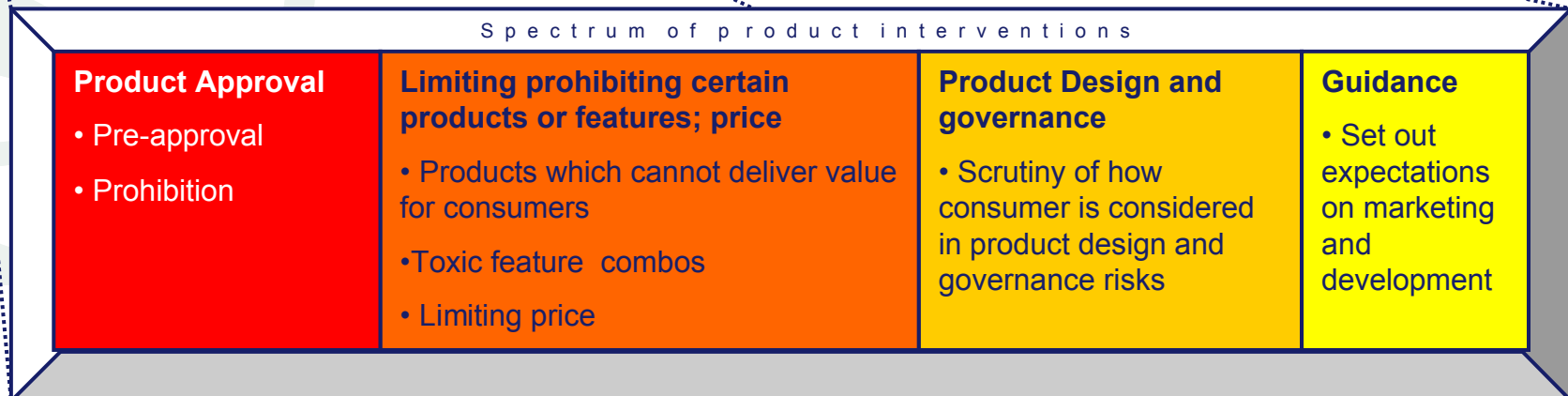
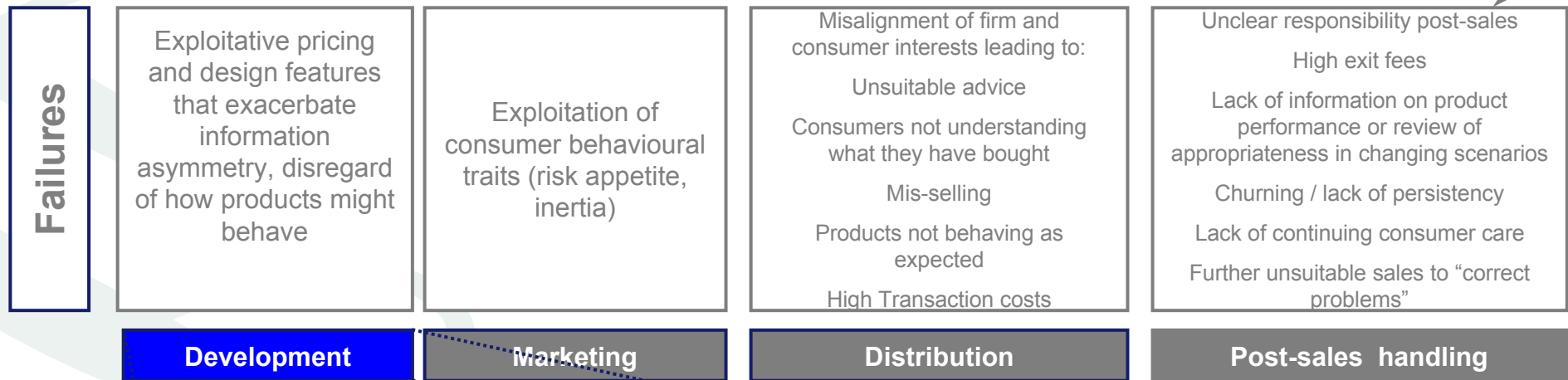


Prioritisation and choice of action.

Conduct strategy 2: Earlier intervention



Where market failure can occur in the product life cycle



Conduct strategy 3: Sector-wide intervention FSA[®]

- **Analysis of the value chain and incentives in a particular sector as a whole**
- **Willingness to intervene to change incentives and relationships which result in poor outcomes for consumers**
- **Often requires significant changes in firms' business models (eg remuneration).**

Conduct strategy 4: Product Scrutiny FSA[®]

Challenge to firms:

- **What are the systems and controls you have to manage product design?**
- **How do you identify and appropriately manage the risks in the product design?**
- **How do you followed through and check in practice when marketing and providing products?**

Conduct strategy 5: More intensive supervision



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- **Core Conduct Programme:**
 - For High Impact Firms, a more consistent and intensive supervisory framework for conduct issues.
 - Increased focus on emerging risks and environmental factors.
- **Firm-specific business model analysis; understanding the drivers of profitability in retail firms and the conduct implications of firms' strategies.**
- **Outcomes testing**
- **Learning lessons from Treating Customers Fairly programme to ensure that the above is a mainstream part of the supervisory processes.**

Conduct Strategy 6: Credible deterrence



Stronger enforcement:

- **Supporting intrusive supervision and a credible proactive stance.**
- **The deployment of these tools will require evidence of likely consumer detriment.**
- **We acknowledge a number of challenges:**
 - Litigation risk when using more robust powers
 - The earlier in the process the FSA wishes to intervene, the more robust the evidence and analysis must be.
 - As well as new cases there will continue to be a caseload dealing with retrospective harm.

Conduct Strategy 7: Improved Redress



- **Financial Ombudsman Service and Financial Services Compensation Scheme relationship**
- **New Co-ordination Committee proposed for mass complaints (with Office of Fair Trading)**
- **European policy development on guarantee schemes**
- **Review of compensation limits; ongoing work on complaints handling**

Conduct strategy 8: Early and effective influencing of conduct issues in Europe



- **Proactive and responsive engagement policy engagement**
- **Need to continue our success through:**
 - Direct use of FSA resources in secondments;
 - relationship building;
 - chairing and participation bilaterally and at EU-level in relevant Level 3 Committees (3L3) and working groups;
 - intelligence gathering and early policy input across all relevant EU institutions.
- **European Supervisory Authorities (ESAs) – implications on policy making and supervision**
- **Thought leadership on key issues to frame agenda**