How financial inclusion and consumer issues might impact on the new Financial Conduct Authority

Financial regulation in the UK is undergoing extensive and far-reaching reform, leading to the Financial Conduct Authority replacing the Financial Services Authority in 2013. This paper sets an agenda for how the FSA and consumer groups can ensure financial inclusion is recognised as a clear market outcome for the new regulator.

The paper reports on a seminar held in 2012 to discuss financial inclusion in the new regulatory environment. Representatives from consumer advocacy groups and the Financial Services Authority attended. Organised by the Friends Provident Foundation, in conjunction with the Financial Inclusion Centre, the seminar was facilitated by Mick McAteer and Danielle Walker Palmour. This paper represents a summary of the views and opinions expressed during the seminar, and may not be representative of a particular organisation or individual.

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A summary of the key issues

KEY ISSUES FOR THE REGULATOR

Measure outcomes, monitor the market The FSA is working on new ways of measuring outcomes and monitoring the market and would welcome consumer groups' views and opinions on developing systems that improve such monitoring. It is interested in how to define exclusion and inclusion. This is particularly relevant now given the amendment to the Financial Services Bill tabled by the Government,[1] which will allow FCA to have regard to access issues.

Get consumers involved The FSA welcomes consumers' views, and is improving communication with groups that represent consumers and reaching out to consumers themselves to find out what they think.

Define the boundaries The FSA is aware of the need to clearly identify the boundary of its remit, because areas that have been theoretically outside its scope in the past have ultimately had huge impacts within that boundary.

Setting priorities Historically, the FSA has prioritised the biggest examples of market failure – where there was clear evidence of things having gone wrong – but it would like to improve on pre-empting risks in future.

Basic needs The FCA is interested in considering just how much access to what sort of, and how many, financial products is appropriate, particularly in relation to what constitutes basic needs.

Consumer credit The transfer of consumer credit powers to the FCA is likely to be a phased one.

KEY ISSUES FOR CONSUMER GROUPS

Consumer groups have an essential role to play in the coming months prior to the launch of the FCA, and once the FCA is up and running, both in supporting the FCA with valuable information and challenging it to meet consumers' needs.

It is important that consumer groups:

- contribute to the development of the philosophy and approach they believe the new regulator should have;
- clarify thinking about metrics for a 'functioning market' in terms of financial inclusion and exclusion;
- specifically, define what factors indicate that a financial product is failing consumers – such as no or limited choice, false choices and punitive pricing.

1. Page 22, line 9: 'the ease with which consumers who may wish to use those services, including consumers in areas affected by social or economic deprivation, can access them'.

Focusing on the interests of ‘non-consumers’ as well as consumers was considered important by consumer representatives.

Consumer representatives suggested that one way of improving the position for vulnerable consumers would be to put in a ‘have regard’ to incorporate the ease with which consumers can obtain relevant services would be. An amendment has been made to the Bill with very similar wording to this suggestion – see above.

However, consumer groups will still have to work hard to ensure that financial inclusion stays high on the FCA’s agenda, and that potential financial consumers are also considered, particularly given the amendment described above.

BACKGROUND

In 2013, the Financial Conduct Authority replaces the Financial Services Authority. The FCA has the potential to become one of most significant actors in terms of financial inclusion in the coming years

Consumer groups are keen to ensure that less well-off and financially vulnerable consumers experience improved outcomes when they interact with financial services, and that their interests are properly represented in the new regulatory environment. They also want to make sure that financial inclusion stays on the policy agenda and is fully incorporated into the new regulator's work. A recent amendment tabled to the Financial Services Bill (which establishes the FCA) allows the FCA when regulating the industry to 'have regard' to the ease with which consumers can access financial services, including those who live in social or economically deprived areas. This does not perhaps go as far as some campaigners would like, as it does not require the FCA to actively promote financial inclusion.

Nevertheless, it puts access on the regulatory agenda. The challenge now for campaigners is to ensure that the FCA takes access issues and financially excluded groups into account when evaluating the success or failure of financial markets. Consumer groups will have many opportunities to share their views with regulators on how to understand and measure the impact of the actions (and indeed inactions) of many financial firms on financially vulnerable groups.

In preparation for the new regulator, senior FSA staff are already working on a new approach to regulation to help the FCA improve consumer outcomes. It has stated that it is in 'listening mode' and wants better communications with consumers and consumer groups.

MEASURING IMPACT AND OUTCOMES

The FSA is implementing an exploratory programme to measure the impact of the FCA

The work underway is reviewing previous work on outcomes measurement by regulatory bodies including the FSA. The research interviews a wide range of external stakeholders and explores what should and shouldn't be in scope, and considers how other organisations measure their own efficacy.

The final measurement tool could incorporate traditional market research perception indicators but will also involve liaising with consumer groups and financial firms. It is anticipated that it will be launched before the legal change to FCA.

The FCA will prioritise market intelligence, and will have more ability to act

In order to be effective, the FCA will need to determine how it can stop some things happening, and encourage others to happen. Better market intelligence and the ability to intervene earlier and more firmly on issues such as product design will support this ambition. To sustain this approach, the FSA is looking to improve communications with stakeholders in the marketplace and with consumers who might struggle to get their views across at the moment.

The FCA's new powers over consumer credit would be phased in and not be a straight handover. This requires dialogue and partly depends on the financial services bill.

OPPORTUNITIES TO INFLUENCE

Consumer groups have the opportunity to influence the FCA's priorities, if they plan and act now. However, they must consider their own priorities before attempting to influence the FCA's

Each of the three new institutions (the Financial Policy Committee, the Prudential Regulation Authority and the Financial Conduct Authority) will be critical to the success or failure of the UK's financial services sector. However, the FCA will be the most important in terms of the deal ordinary people get from financial services. Consumer groups with an interest in financial exclusion therefore need to get involved in informing the FCA's approach, in order to achieve an appropriate degree of consumer protection and effective competition.

Getting involved in the debate about the FCA will give participants the opportunity to shape its philosophy and approach. However, it is important to make a distinction between what consumer groups consider 'essential' issues that must be considered when devising the scope of the new regulator, and those they see it as 'desirable' to consider.

An essential consideration is where the responsibility lies between financial firms, the FCA and consumers

The FCA must consider whether the level of care providers give to consumers is appropriate considering the risks involved and their capabilities. It should base its work on the general principle that consumers must take responsibility for their decisions.

It is also essential that the FCA consider information provided by the Money Advice Service about areas of consumer confusion or distress.

The FCA will have a portfolio of interventions at its disposal and the choice of intervention will depend partly on how confident the FCA is about how effective the Money Advice Service is being at improving levels of financial capability. The MAS also provides a potentially invaluable feedback loop to the industry and the regulator about emergent consumer issues.

Vulnerable consumers must be prioritised

Unless the FCA is convinced that the interests of vulnerable or low-income consumers are a priority, it will not prioritise issues affecting them. The FCA's new chief executive designate, Martin Wheatley, has expressed interested in the social impact of financial services on different types of consumer, and it is important for consumer groups to ensure that the FCA's level of interest in this remains high.

Getting the FCA to focus on 'the consumer' is vital

From a financial inclusion viewpoint, a consumer is anyone who uses, has used or may in the future use regulated financial services. This is wider than the FSA's current approach, which tends to focus on who uses the financial markets regularly. Those with an interest in financial inclusion should convince the FCA to factor in current non-consumers, i.e. those who might be consumers at some stage.

The impact of the FCA on those vulnerable to market failure is of central concern in achieving financial inclusion. This includes those who are not using financial services at all or minimally, or who don't have a bank account. Another group of people are engaged on some measures, for example they have a savings account or current account, but use them minimally. Defining who is vulnerable must take into account the fluid nature of this group – individuals can fall into a vulnerable group and can then move back out of it.

How interventionist should the regulator be?

The principle of product initiation as opposed to product intervention is not in the reform bill at the moment, and it would be a big policy step to move from the current position of regulation of the market, to saying 'the industry must supply' or 'the Government must supply'.

Many of the barriers to financial inclusion that consumers face relate to the types and efficiency of the services provided by financial institutions and the way these institutions behave towards consumers (or 'conduct' issues). The FSA is used to dealing with poor conduct issues in the investment or lending markets, where the amount of detriment can be huge. But the FCA will need to develop ways of dealing with similar issues in the banking sector, which is important to vulnerable consumers even though the detriment might be not be obviously huge in 'pound' terms.

DEFINING A FUNCTIONING MARKET

One challenge for the FCA is how to define an effective/functioning market

The evidence for the social impact of the financial market is currently very patchy. However, budget reductions will further reduce the ability of consumer groups and researchers to measure the social impact of financial markets. The FCA could play an important role in maintaining an evidence base.

It is important that the FCA is not put in a position where for political reasons they are deemed responsible for an effective market but are not given the resources or the power to do anything about it. Responsibility for social policy rests with politicians, but the regulator is in the position to notice issues in the financial market that are causing problems for consumers. Regulators have a role to tell Government about a gap, and then also be involved in implementing policy aimed at improving the situation.

A first step for the regulator would be to define what a functioning market is, from the perspective of different groups of consumers. A second step would be to identify consumer detriment, i.e. where and when markets fail different groups of consumers, and then identify why markets fail. It would then need to identify the different interventions to make markets work.

Identifying different groups of consumers is a challenge because people's situation changes over their lifecycle. Some people are totally disengaged from the financial market, and others are engaged by life cycle events such as house purchase, divorce or the death of a partner. People easily move between groups.

Access to the market is central to its effectiveness – the biggest indicator of market failure is lack of access.

Setting the boundaries of regulation is a key issue

To date, the FSA has concentrated its work on areas where it has had the power to act. This is something the regulator is trying to address. However, the issue of defining the perimeter of regulation is difficult, as issues that start to go wrong outside this perimeter, or appear only to have a small impact inside the regulatory perimeter, can grow to create big problems for the regulator itself, such as happened with shadow banking.

In terms of consumers, some have also moved in and out of this regulatory perimeter (for example those with issues about payday loans).

IDENTIFYING ISSUES

Money Advice Service

Money Advice Service (MAS) first looks at particular groups, then life stages, then attitudes to money across the various life stages. It has focused its funding on where there were market failures and by asking where people can access advice, how they do it and in what ways.

MAS is funding face-to-face debt advice with marginalised people, addressing their advice needs, not their preferences. This is an area where there is market failure – people are using services that can cost them a lot of money and entrench their problems.

How the regulator prioritises its actions is a key issue for consumer groups

The regulator has historically prioritised the biggest problems, usually later on in the process. It now wants to pick up potential problems a lot earlier, though its new powers in this regard are as yet untested, and the challenges of doing so are considerable.

It is possible that the FSA could look to how industries with reporting systems operate to track problems at the earliest opportunity. For instance, the Civil Aviation Authority logs all small incidents, categorises them and over time can see patterns that need addressing.

Developing a framework for consumers' interests

Most public policy regulators have a social policy statutory framework, but the FCA does not, so another way has to be found to push these consumers' interests up the agenda.

In the last few years, risk assessment had been about prudential regulation but conduct issues would rise up the agenda because it now had its own organisation. The link to financial firms will weaken, with the FCA becoming a conduct regulator. This would allow a more thematic approach, though the regulator is still several steps, including some conceptual steps, away from how this would work in practice.

The regulator concentrates on problems that are most immediate and pressing, and as a result other significant problems with broad effects might get missed. However, enforcement strategy is driven by how egregious the breach is, by whether the FSA has enough evidence to win, and how many similar cases they have handled before. So, for example, where many cases are similar, the regulator might then go further down the list to highlight another area.

An emphasis on data published quarterly could help highlight significant problems, as could building models rather than having teams across the banking sector, pensions, fund management and insurers coming up with different detriments where actually the underlying cause was the same.

Pricing and profits are good indicators of a possible problem

For example, price clustering – where prices are clustered at two ends, for the better off and the less well off, with many providers basically offering the same product to the less well-off – could indicate problems with choice.

Disclosing the cross-subsidisation of financial products would increase transparency. Pricing structures also need to be looked at, to ensure they don't result in consumers being penalised for their financial behaviour.

Excessive profits can also be an indicator of market failure. There hasn't been a specific requirement not to cross-subsidise, so if a company spots a risk it can price that risk accordingly.

CONSUMERS

It is important to consider consumer outcomes, using established consumer principles

The first principle is whether consumers have access to appropriate products to meet their needs. The second is safety and security. In financial circles, security is usually prudential security, but legal security is often the 'Cinderella' concern. Security should include contractual security – for example, can consumers trust that their contracts are legitimate and enforceable?

Other outcomes include choice, fairness and integrity, meaning that consumers should be treated fairly and protected from unfair and illegal market practices. Consumers should have access to value-for-money innovative products and services from competitive and efficient markets. But competition is a means to an end, not an end in itself.

Another issue is whether consumers are being offered functional and socially useful products and services. Just as with the wholesale market, there are some socially useless products in the retail market. Information and advice including pre-sale, point-of-sale and post-sale information doesn't always work.

Consumers should be able to enforce their consumer rights but have access to redress.

The one thing the FCA could do for promoting financial inclusion is to require greater transparency and efficiency.

It is important for the regulator to ensure consumer representation, and to explain how it will incorporate consumer views into its work

Other organisations have experience in this regard. Fair Banking has an element of direct consumer feedback with regard to products, although its starting point is a definition of financial well-being. The Payments Council has asked questions of older people and people with disabilities, which they integrate into their thinking.

Consumers sometimes have priorities that seem to be at odds with the seriousness of the issues – worrying, for example, about currency exchange rates at airports rather than about badly performing pensions.

Ensuring access, and the right product, are two different things

Financially excluded individuals and non-users can have different views.

A lot of people that are newly banked have high expectations about what a product is supposed to do. They may in the past have managed without banks, and there is a risk they may be put off banks altogether if they experience hidden charges or unauthorised overdraft charges. Banks may give them access but fail to retain them. This was the case for many customers with basic bank accounts, who never went on to engage with wider financial services. One way of retaining customers would be to enable basic bank account holders to have more face-to-face interaction before they open an account.

Basic bank accounts have had a social value for ex-offenders, whether they helped them manage their money better or not, and the FCA should perhaps factor that into their thinking.

However, ensuring access per se isn't enough – consumers should have access to the right product. It is important for people to choose the right bank account for them. This requires that products are equally available to all. For some consumers there has been very little choice. Although addressing basic financial needs is an established aim of financial inclusion, it is possible that this has restricted the products available to the people who use them, and that consumer principles, or a consumer 'needs' approach, could be an alternative framework.

The FCA might then measure market outcomes in terms of the ability of people to meet their needs, rather than access.

How much responsibility can be placed on consumers themselves?

There are some consequences people should not be exposed to, such as losing their pension. In addition, the technical complexity of some products can make it hard for people to have a full understanding of them, and make a rational choice.

The FSA used to put a lot of weight on disclosure, but products appeared to be getting more complex. It has debated whether food standard-style labels for risk would be appropriate for financial products too, though this has been considered too complex. It would certainly be revealing if some people's only options were 'red', or 'unhealthy', and it might also stimulate innovation to provide something better.

It is possible that some people could resist substantial interventions as too paternalistic. However, given the serious and complex nature of the financial market this is unlikely. When it comes into the public policy debate, the case is usually made that people need support to take decisions about products, hence advice providers are regulated.

Possible next steps

- Groups should cooperate to ensure FCA maintains a focus on access to financial services.
- Do the consumer groups concerned wish to consider developing a common approach or agreement about areas of common ground, setting out what they would like to see in terms of financial inclusion under the new regime?
- Should the groups consider meeting regularly during the legislative process at a policy level to consider areas of common agreement or concern?
- How can the groups help the regulator in creating and evolving its new approach, particularly in its work to monitor the market, obtain improved market intelligence and improve outcomes in terms of financial inclusion?
- Should the groups call on the regulator or Government to reinstate research into financial inclusion and exclusion?
- Should the groups concerned establish their own research to measure financial inclusion or specific impacts?
- How can consumer groups help the FCA in terms of improving communications with consumer groups and consumers themselves?

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