FairPensions™
The campaign for **responsible** investment

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To whom it may concern,

FairPensions welcomes this opportunity to respond to the consultation *'A new approach to financial regulation: the blueprint for reform'*.

Introduction

FairPensions (FairShare Educational Foundation) is a registered charity established to promote responsible ownership practices by pension providers and fund managers. FairPensions champions greater transparency and accountability to the millions of people whose long-term savings are managed by institutional investors and other professional agents. FairPensions believes that responsible investment helps to safeguard investments as well as securing environmental and social benefits.

We work primarily with pension funds and their investment managers, and as such our comments focus primarily on questions relating to the FCA. However, we also make some comments about the proposed PRA.

In general, we welcome the government's proposed approach. However, we have two key concerns, both of which have been alluded to in our previous responses:

- We continue to have concerns about the 'consumer responsibility' principle which we do not believe are fully addressed by the draft Bill.
- We continue to be concerned that investment governance and responsible ownership may fall between the cracks of the new regulatory architecture, despite its importance both to outcomes for consumers and to preventing the build-up of systemic risk.

These and other issues are elaborated in our response to the specific questions below.

Question 4: Do you have any comments on the objectives and scope of the PRA?

We agree with the PRA's insurance objective and believe it is right that this objective should be focussed on the protection of policyholders and potential policyholders. We also welcome the government's indication that the PRA's responsibilities in relation to policyholders will need to be exercised in close co-ordination with the FCA.

Our particular interest lies in the specific case of pension savers as policyholders. We are concerned that this group may be particularly vulnerable since they bear the investment risk on their savings but are not protected by the same stringent legal duties and governance structures that exist in trust-based pension arrangements. We believe that the duties of insurance companies towards their policyholders may need to be strengthened and have made representations to the FSA on this matter (see attached paper). We therefore believe that this is a particularly important area for co-ordination between the PRA and FCA, and would welcome proposals from the government to supplement the co-ordination MOU in ensuring effective consultation. See also our response to Question 13.

It is an odd consequence of the redrafting of the PRA's objectives that the FCA now has an objective of "*protecting and enhancing the integrity of the UK financial system*", including *"its soundness, stability and resilience",* but the PRA has no such objective. We would question whether the proposed new section 2B(3) of FSMA is sufficient to reflect the PRA's intended role and focus, or whether the promotion of financial stability continues to be deserving of an objective in its own right.

We continue to have concerns about the drafting of the regulatory principles, particularly in relation to consumer responsibility. Please see our comments in response to Question 6.

Question 5: Do you have any comments on the detailed arrangements for the PRA?

As indicated in our previous response, we are disappointed by the decision not to retain a Consumer Panel for the PRA, particularly given the responsibility it is being given for the protection of policyholders. Retaining a requirement to consult with industry but not with those whose capital and financial wellbeing is at stake seems at odds with the government's stated aim of creating a more robust and effective regulatory system.

We believe that this decision renders even more crucial the government's recognition that the PRA's engagement with industry must be transparent – not for the sake of the regulated community itself, but rather in order to mitigate the risk of regulatory capture. Transparency is vital not just on the PRA's processes for consultation but also on the operation of those processes: ie. which entities are making representations to the PRA, on what issues, and how the PRA has engaged or responded, whether formally or informally.

Question 6: Do you have any views on the FCA's objectives?

We welcome the reordering of the FCA's objectives so as to give priority to the consumer protection objective rather than the efficiency and choice objective. We believe this better reflects the government's stated intentions for the FCA.

However, we continue to have concerns about the principle of consumer responsibility which we do not feel are fully addressed by proposed new section 1C(2) of FSMA. Indeed, to an extent the law recognises that the principle of 'caveat emptor' is inappropriate in financial services: this is precisely why fiduciary duties apply to agents responsible for managing other people's money. As indicated in our previous consultation responses, it is impossible to eliminate the information asymmetries that characterise financial services, and therefore to arrive at the conditions necessary for informed consumer choice to be a reliable tool for achieving fair and efficient outcomes.

This is particularly true in the case of long-term savings vehicles such as pension products, where, as former FSA Chairman Howard Davies has noted, *"there is little that investors can do by way of withholding their business, and, by the time the effect of this conflict is evident, it is likely to be too late for investors to act."*[1] We therefore consider that the principle *"consumers are responsible for their decisions"* can be accepted only with significant qualifications. In particular, we would suggest that the Bill should explicitly qualify, or indeed disapply, this principle in relation to long-term investment products, for the reasons given above. The particular vulnerability of consumers of such products is not adequately captured either by proposed section 1C(2)(a), which deals with investment risk, or 1C(2)(b), which deals with consumer experience and expertise.

We continue to believe that the issue of investor stewardship and governance should be accorded greater priority within the regulatory framework and that the FCA's remit might benefit from an explicit requirement to 'have regard' to, for example, the importance of promoting effective stewardship of listed companies by institutional investors. Alternatively, the FCA's rule-making powers in relation to shareholder rights and responsibilities could be strengthened.

Question 7: Do you have any views on the proactive regulatory approach of the FCA?

We strongly welcome the proactive approach detailed both in this White Paper and in the FSA's subsequent paper, '*Financial Conduct Authority: Approach to Regulation',* published in June. As indicated in our previous response, we believe that more robust tools, such as the proposed product intervention power, clearly offer benefits to consumers which far outweigh the likely reduction in choice.

We believe that the FCA's proposed approach to product regulation is complementary to the focus on firm culture and governance pursued through its 'Treating Customers Fairly' initiative. We believe that these factors remain crucial to consumer outcomes and would only caution that the enhanced focus on early intervention to prevent mis-selling should not lead to a correspondingly weaker focus on ongoing intervention to ensure that conflicts of interest are properly managed and that firms are putting clients' interests first. In this regard, see also our comments on the importance of investment governance in response to Question 13.

Question 8: What are your views on the proposal to allow nominated parties to refer to the FCA issues that may be causing mass detriment?

[1] Sir Howard Davies, *'Conflicts of interest for banks, auditors and law firms',* in Clark (ed.), 2005/06, *'Conflicts of interest: Jurisdictional comparisons in the law and regulation for the financial services, auditing and legal professions',* European Lawyer Reference.

Question 9: What are your views on the proposal to require the FCA to set out its decision on whether a particular issue or product may be causing mass detriment and preferred course of action, and in the case of referrals from nominated parties, to do so within a set period of time?

We welcome these proposals, which we believe will make a significant contribution to the FCA's ability to investigate and deal with potential or actual consumer detriment. This would also provide an appropriate channel for consumer groups and others to raise matters of concern, thus perhaps helping to address the 'inequality of arms' between consumer groups and regulated entities.

Question 12: Do you have any comments on the governance, accountability and transparency arrangements proposed for the FCA?

We are somewhat concerned that the existence of three practitioner panels and only one consumer panel in a regulator intended to be a "strong consumer champion" may send out the wrong message. We recognise that different groups of practitioners have different needs and interests; however, as we have pointed out in our previous responses, the same is true of consumers. The consumer panel is expected to represent an enormously wide range of consumers of vastly differing products (from mortgages to unit trusts to pension products), with different levels of experience and expertise, different levels of risk exposure, etc.

We suggested that it might be appropriate to specify the range of interests and/or expertise which must be represented on the panel to ensure that particular sub-groups of consumers are not neglected. It seems to us that a similar approach could have been adopted in relation to the practitioner panels, and that this might have resulted in a more proportionate and balanced framework. In our experience, the FSA's engagement with regulated entities is already far wider, deeper and more extensive than its engagement with consumers and civil society organisations; indeed, FSA officials privately acknowledge this. We are somewhat concerned that the new regulatory architecture may not mark the fresh start we had hoped for in this respect.

It might be appropriate for the consumer panel to be larger than the respective practitioner panels in order to redress any perceived imbalance. We also continue to believe that there would be value in measures to ensure that the consumer panel represents an appropriately wide range of interest and expertise, as outlined in our previous responses.

Question 13: Do you have any comments on the general coordination arrangements for the PRA and FCA?

Co-ordination between the PRA and FCA is important not just because of its potential to reduce burdens on dual-regulated firms, but because of its contribution to effective regulation. As we have argued previously, it is vital that in seeking to address the 'cracks' created by the previous system, the government does not inadvertently create new gaps in regulation. Effective co-ordination – not just between the PRA and FCA, but also with other relevant regulators such as the Financial Reporting Council (FRC) and The Pensions Regulator (TPR) – is essential if this risk is to be minimised.

We therefore understand the reasons for the inclusion of proposed section 3D(1)(c), which specifies compliance with regulatory principles in relation to matters of common interest

as one objective of regulation. However, we believe it is important that the narrative around co-ordination does not focus solely or largely on this objective at the expense of the purposes specified in 3D(1)(a) & (b). For this reason we also disagree with those who have suggested that the industry should be consulted in the drawing up of the MOU.

We would also suggest that the purposes of co-ordination might be framed not just in relation to what each regulator *is* doing, but also what it is *not* doing. One of the criticisms made of the previous tripartite regime prior to the financial crisis was that important risks went unchecked because no single body had effective responsibility for managing them. If one regulator does not aggressively pursue an issue that is brought to its attention on the basis that it falls within another regulator's remit, it is important that some co-ordination takes place to ensure that the second regulator has not also neglected the issue on the basis that it does not fall within its remit.

As indicated in our previous responses, we believe that investment governance is one issue which has the potential to fall between two regulatory stools – as indeed it arguably does under the current regime. For , in the dual regulation of insurance companies, the PRA is likely to focus on solvency issues and the FCA on product regulation and sales processes. This runs the risk that neither regulator is attending to the behaviour of these firms as market participants and as owners of major companies, including other financial industry entities. We continue to believe that the framing and exercise of the PRA and FCA's co-ordination duty should reflect the need to be vigilant against the emergence of gaps in regulation.

We remain at your disposal and would be pleased to meet with you to discuss any of the issues raised in this response.

Yours sincerely,

Christine Berry

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