Call for Written Evidence: Financial Services and Markets Bill

From Transparency Task Force, in an organisational capacity
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A. Executive summary

1. The evidence shows the UK's financial sector has a poor violations record.

2. The malpractice that occurs has victims. For example, real people's lives are ruined as a consequence of their losing life-changing sums of money due to the kind of chronic and catastrophic regulatory failure that has been taking place.

3. The financial services sector itself has a great deal to gain through the regulatory framework working effectively; reputation matters, and UK Plc needs to have a good reputation moving forward.

4. We believe there is an urgent need for greater democratic accountability of our regulatory framework, both directly to consumers and via our elected representatives, so that the financial services sector can serve society better.

5. We also believe that *more effective* regulation (as opposed to just *more regulation*) will boost the reputation of the UK's financial sector, thereby making it more attractive on the world stage, boosting competitiveness and enhancing the prospects for real and sustainable growth.

6. We note that there are widespread and well-founded concerns about the performance of the Financial Conduct Authority ('FCA') against its existing

operational objectives; we share these concerns, and believe they must be resolved if the financial services sector is to serve society better and contribute optimally to long-term growth and international competitiveness.

7. Our submission therefore outlines what we see as the principal weaknesses in the operations, culture and governance of the FCA and outlines three measures designed to address them; we ask the Committee to consider introducing amendments to the Bill encapsulating these proposals.

8. We are working with supportive MPs, Peers and lawyers on the drafting of the abovementioned amendments, and would welcome an opportunity to discuss them with you. Andy Agathangelou, Founder of Transparency Task Force, and Mark Bishop, lead author of this paper, are available to provide evidence to the Committee.

B. About the Transparency Task Force ('TTF')

9. TTF is a certified social enterprise, established in 2015, whose mission is 'to promote the ongoing reform of the financial sector so that it serves society better'.

10. We have more than 6,000 members and supporters in 21 countries, some 80 percent of them in the UK. They range from consumers who've been mistreated by the financial services sector to whistleblowers, industry professionals intent on raising standards and other relevant stakeholders such as academics and journalists.

11. We are funded through voluntary membership fees and individual donations; we are not in receipt of funding from firms from the sector, nor from charities and foundations resourced by it.

C. Our goal: progress begins with realism

12. The purpose of this part of our paper is to help ensure the reader understands how badly behaved parts of the UK's financial sector is, how ineffective regulation appears to be in taming it, and thereby how ripe it is for meaningful reform.

13. We believe that the financial sector is profoundly important to the wellbeing of society, to economic stability and to political stability too.

14. Because the sector is of systemic importance to the UK's economy and because it needs to be trusted to function successfully, one would think that the regulator tasked with its governance would regulate and enforce sufficiently well enough to ensure good market conduct and a healthy reputation for the sector.

15. However, that is not the case - the regulatory framework is failing to ensure good market conduct, as evidenced by data within Violation Tracker UK. The data shows the financial sector to be the most violating of all the parts of the UK economy, by a disturbingly long way.

16. The screenshot below shows the amounts paid in fines and the number of violations, from the worst-offending sectors, going back to 2010. As you can see, that list has the financial services sector at the top of it. That's clearly a problem for what is meant to be our 'jewel in the crown' sector.

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Violation Tracker UK Parent Industry Penalty Totals

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RANK	PARENT MAJOR INDUSTRY	TOTAL PENALTIES	NUMBER OF CASES
1	financial services	£5,004,910,983	474
2	aerospace and military contracting	£1,564,003,623	82
3	telecommunications	£1,212,372,664	69
4	utilities and power generation	£812,008,895	979
5	diversified	£579,591,306	163
6	pharmaceuticals	£407,759,373	26
7	miscellaneous manufacturing	£334,710,285	63
8	retailing	£225,789,678	255
9	airlines	£211,846,577	44
10	business services	£200,173,220	221
11	private equity (including portfolio companies)	£197,033,596	130
12	oilfield services and supplies	£180,739,109	39
13	miscellaneous services	£179,833,349	261
14	chemicals	£74,277,026	119
15	entertainment	£57,498,560	29

17. Furthermore, the data suggests that the miscreants have become so accustomed to behaving badly that there is now another dimension to the problem, and one that's going to be very hard to fix. The problem becomes apparent when you look more closely at the violations data - the evidence suggests that the financial industry is recidivist, repeatedly offending after being caught, ie being seemingly beyond rehabilitation. Perhaps parts of the sector see being fined for malpractice as a 'cost of doing business'? The screenshot below relates to the Violation Tracker UK data on the individual offences by the financial industry since 2010, ranked by size of fine.

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Individual Penalty Cases:

Click on the company or penalty amount for more information on each case. Click on the parent name to reach the summary page for that parent company.

Download results as CSV or XML (maximum 1000; for access to larger downloads contact Phil Mattera)

COMPANY	PARENT	OFFENCE TYPE	YEAR	AGENCY	PENALTY AMOUNT
Credit Suisse	Credit Suisse	banking violation	2021	UK-FCA	£292,209,276
Barclays Bank plc	Barclays	foreign exchange market manipulation	2015	UK-FCA	£284,432,000
National Westminster Bank plc	NatWest Group PLC	anti-money-laundering deficiencies	2021	UK-FCA	£264,772,619
UBS AG	UBS	foreign exchange market manipulation	2014	UK-FCA	£233,814,000
Deutsche Bank AG	Deutsche Bank	interest rate benchmark manipulation	2015	UK-FCA	£226,800,000
Citibank N.A.	Citigroup	foreign exchange market manipulation	2014	UK-FCA	£225,575,000
JPMorgan Chase Bank N.A.	JPMorgan Chase	foreign exchange market manipulation	2014	UK-FCA	£222,166,000
The Royal Bank of Scotland plc	NatWest Group PLC	foreign exchange market manipulation	2014	UK-FCA	£217,000,000
HSBC Bank plc	HSBC	foreign exchange market manipulation	2014	UK-FCA	£216,363,000
Deutsche Bank AG	Deutsche Bank	anti-money-laundering deficiencies	2017	UK-FCA	£163,076,224
UBS AG	UBS	interest rate benchmark manipulation	2012	UK-FSA	£160,000,000
JPMorgan Chase Bank N.A.	JPMorgan Chase	investor protection violation	2013	UK-FCA	£137,610,000
The Bank of New York Mellon International Limited et al.	Bank of New York Mellon	investor protection violation	2015	UK-FCA	£126,000,000
Lloyds Bank plc and Bank of Scotland plc and Black Horse Limited	Lloyds Banking Group	insurance violation	2015	UK-FCA	£117,430,600

To get the full picture, please access this Violation Tracker UK search that was used to generate the screenshot that you see and once you are on the correct web page, scroll down and look for the pattern of repeat offending, noting that when you get to the bottom of the page, there are many other pages that follow.

18. It is our belief that the pattern of behaviour that the Violation Tracker UK data shows can be explained as follows:

- Firstly, organisations make vast sums of money through one kind of misconduct or another and the people responsible 'earn' substantial bonuses

- The organisations eventually get caught by the regulator, typically far too late and often after ignoring whistle-blower evidence that should have led to swift and decisive action. Unfortunately, the whistle-blower often suffers for having done the right thing
- The regulator eventually imposes a fine
- The fine is against the organisations, not the individuals responsible; so the fine is effectively paid by the organisation's innocent shareholders - individual investors, pension savers and so on
- The headline size of the fine is typically large, but small in comparison to the profits 'earned' by the organisation
- The vast bonuses 'earned' by the individuals responsible are rarely reclaimed, despite the immorality and sometimes even the criminality of their conduct
- The individuals responsible are very rarely sanctioned, even though the Senior Managers Certification Regime (SMCR) was put in place to create personal jeopardy for miscreants. It should be noted that, according to former Governor of the Bank of England, Mark Carney, the single most important regulatory response in the UK to the carnage caused by the banking misconduct that led to the Global Financial Crisis was the need for and introduction of the SMCR. However, it has hardly ever been used
- The entire process has quite literally taught the offending organisations and individuals responsible that "it pays to cheat," so like true recidivists they repeat the process. Charlie Munger's quote "Show me the incentives, and I'll show you the outcome" is an apt explanation for the organisational and individual behavioural dynamics at work ie it would be surprising if they *didn't* behave that way, given the strength of the incentive to do so and the lack of deterrent due to poor oversight and enforcement

The end result is we now have a financial sector riddled with companies that have toxic, predatory cultures that cause untold harm; and a financial regulatory framework that is placing a fig-leaf on malpractice, effectively encouraging organisations to see fines and regulatory impositions as merely 'a cost of doing business.'

19. It must always be remembered and stressed that for every financial crime or act of malpractice, malfeasance, misconduct or mis-selling by the financial sector, there are victims. Those victims are *the innocent members of the public* who have had the misfortune of falling prey to the criminal and unethical actors in this space, of which there are thousands, if not tens of thousands, preying on hundreds of thousands of people. It needs to be understood that the scale of the problem is huge; and far from being gradually managed down, things are getting worse, perhaps even out of control.

20. It is of systemic importance that the UK's financial sector and its regulatory framework is respected on the international stage. However, there are many reasons to be deeply concerned about the fundamental integrity of our finance sector and the level of trust and confidence people should place in it.

For example, consider this:

Back in 2016, the Bank of England's Chief Economist gave a speech commenting on the findings of an Open Forum that the Bank of England ran to gather views on the financial sector. People were invited to give the one word that best described the sector. Andy Haldane stated:

'Among the Bank's usual contacts, including those in the financial sector, the most used word was 'regulated'. Many of us will have heard that message from financial insiders concerned about the perils of over-zealous regulators.

For me, the more revealing responses came from the general public, from the customers, rather than the producers, of financial services. The word most used by them when describing financial markets was a rather different one: it was "corrupt". Not far behind were words like "manipulated", "self-serving", "destructive" and "greedy". I am sure many of you have heard those messages too. They are certainly ones I have encountered frequently on my visits around the country.'

So, why does all this matter? And why is it especially important *right here, right now,* when Parliament is considering amendments to the Financial Services and Markets Bill?

We can go back to Andy Haldane's speech for the answer to those questions:

'At least until recently many economists like me, when faced with this evidence [that the finance sector is perceived to be "corrupt", "manipulated", "self-serving", "destructive" and "greedy"] might have shrugged our shoulders. Social capital had no real role in our models of economic growth, unlike physical capital and human capital. Trust did not butter our parsnips and nor did it enter our production functions.

Recently, however, that orthodoxy has changed and the importance of trust has become clearer. Evidence has emerged, both micro and macro, to suggest trust may play a crucial role in value creation. At the micro level, there is now ample evidence the degree of trust or social capital within a company contributes positively to its value creation capacity. At the macro level, there is now a strong body of evidence, *looking across a large range of countries and over long periods of time, that high levels of trust and cooperation are associated with higher economic growth.*

Put differently, a lack of trust jeopardises one of finance's key societal functions – higher growth. Those social capital effects appear to be particularly potent when it comes to financial decisions. Evidence suggests that a lack of trust leads people to retreat from the stock market and banks and to move towards cash holdings and informal sources of credit, such as payday lenders and loan sharks. That jeopardises the second key benefit of finance to society – improved risk-sharing by households and companies.

So a lack of trust in finance potentially hobbles both economic growth and financial stability.

That lack of trust is the mirror-image of the perception gap between the financial sector and wider society, the Great Divide. The Great Divide matters because it signals a pronounced and protracted erosion of social capital. It puts finance on notice for losing its social licence. And, unaddressed, that jeopardises future wealth and well-being.'

21. As you read through the rest of this document, please bear in mind these key points:
    - The evidence shows the UK's financial sector has a poor violations record. On the basis that progress begins with realism it's wise to accept that harsh and disappointing reality
    - The regulator's typical response to malpractice ie fining the miscreant organisation's innocent shareholders but not dealing firmly with the individuals responsible seems not to improve market conduct; rather, it seems to encourage recidivism
    - The malpractice that occurs has victims; real people's lives are ruined as a consequence of their losing life-changing sums of money due to the kind of chronic and catastrophic regulatory failure that has been taking place. We know many individuals within our community who have suffered harm as a consequence of becoming a victim due to chronic and catastrophic regulatory failure - there are 22 case studies that you can read about here.

22. The financial services sector itself has a great deal to gain through the regulatory framework working effectively; reputation matters.

23. For all of these reasons, the Transparency Task Force passionately believes that there is an urgent need to reform the way the financial services sector is regulated.

D. Shortcomings of the FCA

24. In the past two years, five significant independent reports have been published that are highly critical of the FCA's performance against its consumer protection objective. These are:

24.1. **Raj Parker's Review of the FCA's Handling of the Connaught Income Fund Series 1 and Connected Companies (December 2020)**. This investigated the regulator's handling of the supervision of a £106m collective investment scheme and its conduct in the three years following its collapse amid allegations of criminality. Parker found that *'the Regulator's regulation of the relevant entities and individuals connected to the Fund was not appropriate or effective'*, noted that it *'could have acted in a more effective way to protect investors in the Fund'* and observed that the regulator's performance in connection with Connaught was not an isolated failing, being *'not have been at material variance from the regulatory orthodoxy at the time'*;

24.2. **Dame Elizabeth Gloster's Report of the Independent Investigation into the Events Relating to the Financial Conduct Authority's Regulation of London Capital & Finance plc (December 2020)**. This explored the regulatory role in and response to the sale of some £237m of unlisted bonds to consumers, a matter that is now under investigation by the Serious Fraud Office. Gloster concluded that *'the FCA did not discharge its functions in respect of LCF in a manner which enabled it effectively to fulfil its statutory objectives… the Bondholders… were entitled to expect, and receive, more protection from the regulatory regime in relation to an FCA-authorised firm (such as LCF) than that which, in fact, was delivered by the FCA'*. She also criticised *'the FCA's delays and errors in providing documentation to the Investigation Team'* and the representations made by it during the Maxwellisation phase of the report's production, especially in relation to demands *'to delete references to "responsibility" resting with specific identified/identifiable individuals'.* It is important to note that when giving evidence at the Public Bill Committee session on Compensation (London Capital & Finance plc and Fraud Compensation Fund) Bill (First sitting), at which Mark Bishop and Andy Agathangelou also gave evidence, Dame Gloster cited the FCA's 'culture' as being the most important issue to be remedied. Her damning comments on the FCA's culture led to Pat McFadden MP making these points later in the day: *"Amendment 2 concerns the recommendations made in Dame Elizabeth's report. It is a long report, but I am specifically referring to the series of conclusions and recommendations made on pages 47 to 49. As the Minister* *said a few moments ago, some of those recommendations are for the FCA and others are for the Government. We heard Dame Elizabeth say this morning that if she reached one overall conclusion that she wanted us to understand, it would be about the degree of culture change necessary for the FCA to fulfil its statutory duties. The fact that she judged that the culture that existed was so inappropriate that it stopped the FCA from doing its statutory job effectively is a serious charge. It is, after all, the body that we depend on to uphold the consumer interest and charged with ensuring proper conduct in the sale and provision of financial services. I do not need to tell anybody on the Committee how important those are, either to everyday life or to the UK economy"*;

24.3. **The Work and Pensions Committee's Protecting Pension Savers – Five Years on from the Pension Freedoms: Pension Scams report (July 2021).** This report addressed how best to tackle the growing phenomenon of the perpetration of investment frauds on individuals following the introduction of 'pension freedoms' in 2015. It raises concerns about not only the FCA's operational effectiveness but also the integrity of the evidence it gave the inquiry: *'The FCA told us that there have been a very large number of prosecutions involving scams and unauthorised business. We do not agree with this assessment. Its own figures—revealed only through Freedom of Information requests—show that there were just 25 convictions. We have heard numerous criticisms that the FCA is not effective in stopping scams, punishing scammers or retrieving scam proceeds. There is a compelling case for a much more ambitious approach*';

24.4. **John Swift KC's Independent Review into the Supervisory Intervention on Interest Rate Hedging Products (December 2021)**, which dealt with the regulator's decisions not to impose a mandatory redress scheme on banks that 'mis-sold' derivative products to SMEs in breach of financial regulations and to create a voluntary scheme that excluded most of the larger claimants. Overall, in addition to a lack of transparency, the Review found that *'the voluntary [Redress] Scheme was an inadequate regulatory response'*. It criticised the regulator for being reluctant to consider Enforcement action (*'Each time this came up for consideration, the decision was taken not to institute enforcement proceedings against any of the banks or individuals… [leaving it] without a viable fallback option and thus arguably in a significantly weaker bargaining position in establishing the Scheme. It also meant that elements of possible misconduct (other than those appropriate to be dealt with by way of a redress scheme) avoided any regulatory action – for example, potential issues such as inappropriate sales incentives and shortcomings in systems and controls were not addressed by the Scheme.'*).

Perhaps the most serious findings by far are those to be found on pages 188-191, which reveal that the regulator came under intense pressure from both officials and HM Treasury ('HMT') Ministers to reduce the banks' liabilities to SMEs by reducing the scope of the Scheme; they also show that such pressure was commonplace, and not confined to the IRHP investigation. While Swift cannot prove that HMT pressure is the reason for 10,000 SMEs being wrongfully excluded from redress, he has also been unable to find an alternative explanation: *'This Review examined the contemporary documents and heard evidence from FCA employees engaged in those discussions and decisions at the time. It has found no explanation why that change was agreed'*;

24.5. **The National Audit Office's ('NAO') Investigation into the British Steel Pension Scheme (March 2022).** This evaluated the regulatory response to the provision of advice by independent financial advisers that resulted in some 8000 members of the British Steel Pension Scheme (a 'gold-plated' defined benefit one) transferring savings out of it and into personal, defined contribution arrangements. Much (perhaps most) of that advice was flawed, with financial incentives influencing its quality. The NAO is careful to avoid overt criticism of the regulator, though its findings of fact are damning. In particular, Figure 10 (page 30) raises serious questions about the FCA's reluctance to pursue Enforcement action against bad actors: for each of the courses of action available to it, five years after the transfer activity peaked, the number of concluded cases was either zero or one. We would add that many of the perpetrators had been associated with previous misconduct cases which resulted in either no sanction or none sufficient to deter them from further wrongdoing, and that there have also been credible allegations that those involved in BSPS transfers have since been associated with subsequent scams

25. The FCA leadership team wants you to accept that these are all 'legacy cases', that 'lessons have been learned' and thus that the regulator's 'shortcomings are now history.' We respectfully disagree, for the following reasons:

25.1 The Transformation Project has not been transformative:

25.1.1. The FCA accepted the findings of the Parker and Gloster reports and undertook to implement a programme of changes overseen by Megan Butler, whom it appointed to a newly created role, as Executive Director for Transformation. We expressed concerns to the Treasury Committee that she might not be the ideal candidate to perform this role, given that she was a founding employee of the Financial Services Authority (the FCA's predecessor), was named as one of those responsible for the LCF debacle in Gloster's report and would have been identified by Parker had he not succumbed to FCA representations to omit names; we then submitted a Freedom of Information request which confirmed our suspicions that there had been *no* external advertising or search for candidates, raising suspicions that the FCA might not have been looking for a transformative leader. We alerted the Treasury Committee to this information and in its LCF report concluded that: *'the FCA was wrong not to have engaged in a fuller recruitment programme for the Executive Director for Transformation role, including the consideration of potential recruits from outside the FCA. It appears that there was a missed opportunity to consider fresh leadership for the Transformation programme. Given that Dame Elizabeth's report cited Megan Butler as bearing responsibility for important areas of failure and that her recruitment was conducted internally with just one alternative candidate, we understand why many will feel that "a buck that does not stop with an individual stops nowhere" when it comes to the personal consequences for those involved with the failings at the FCA in relation to LCF. We recommend that the default position should be that the FCA take a holistic approach when recruiting for critical roles, rather than engaging in a restricted recruitment process. It is not readily justifiable for the FCA to require the firms that it regulates to adhere to the principles of the Senior Managers Regime but seemingly not to apply similar principles internally when there are failings of practice and culture in the organisation. The FCA Board should reflect on whether it has, in this case, met the standards which it seeks to impose upon others. We believe that there are doubts as to whether it has.'*

25.1.2. Butler left the FCA shortly thereafter. The Transformation brief - which had hitherto maintained was so urgent that it could not risk having to wait for an external candidate to work out their notice period - was added to the remit of an existing executive already facing an uphill battle to turn around what Parker and Swift had identified as a struggling department, namely Authorisations - this looked like a clear sign of the project being downgraded in importance;

25.1.3. In an evidence session with the Treasury Committee in December 2021, Charles Randell indicated that he felt the Transformation Project had several years still to run: *'we probably have three years to go before we are very close to where we want to be at the end of this transformation process'* (Q204, here). Since then, its part-time figurehead, Emily Shepperd, has now acquired yet another critical operational responsibility, that of the Chief Operating Officer - and her billing on the FCA website (screen-shot on 24 September 2022, in case the regulator changes it in response to this paper) makes no mention of the Transformation Project. FCA CEO Nikhil Rathi has implied the project is nearing completion and being wound down;

25.1.4. We continue to see evidence of the FCA exhibiting grave shortcomings in areas that were identified as priority targets for transformation. These include staff in the contact centre lacking even the most basic understanding of financial services, complacency faced with wrongdoing that straddles the regulatory perimeter and appallingly inadequate treatment of whistleblowers and their evidence;

25.2. **It is still running away from its obligations to Connaught and LCF victims**. The day after it 'accepted' Parker's findings in respect of the former, which included a finding that investors had not yet recouped all their losses, the FCA posted a statement on its website falsely claiming that *'In total, the FCA's actions in response to the failure of the Fund, have led to investors receiving back, in net terms, the value of their investment… The intention of these payments was to place all investors as closely as possible back in the position they would have been in if they had never invested in the Fund.'* In contrast, Parker acknowledges the existence of unremedied losses[1], but the remit of his work, provided by the FCA, does not allow him to address the issue. In relation to LCF, the FCA has rejected the findings of the Complaints Commissioner, who has recommended that it pays investors compensation making good the shortfall between the sums they received from the Treasury and the totality of their losses;

25.3. **It is also doing all it can to avoid securing redress for wrongly excluded IRHP redress victims**. Having spent £8.6m on the Swift review, the FCA decided to completely ignore its central findings, namely that the 10,000 firms excluded from the original redress scheme deserved compensation, and that it has the power to impose it even now, by ruling out the introduction of a further Scheme. This led to the All Party Parliamentary Group on Fair Business Banking launching a crowdfunded judicial review - proceedings which are currently still in progress and where it's averred the FCA may potentially have

[1] *Inter alia*, pars 7, 8, 11 and 16

breached their duty of candour. What does it say about the FCA's allegiances that it is spending money raised from the industry levy to pursue its operational objectives in an attempt to undermine one of them, namely the consumer protection objective?

25.4. **The FCA seems to believe it is above the law**. Last year, Parliament passed the Financial Services Act 2021, which placed on the FCA an unambiguous obligation to consult, and bring forward rules, on a Duty of Care. The FCA chose instead to consult on, then introduce, what it calls a 'Consumer Duty'. According to no lesser source of legal expertise than the Bar Council, the Consumer Duty is *not* a duty of care; it is materially inferior, both in its many exceptions and because wronged consumers will not have the right to secure monetary redress through civil litigation. We hope Parliamentarians will share our view that a statutory body that believes it can ignore a legal obligation in this way is certainly overdue dramatic improvements in governance, transparency and accountability, and that consumers deserve to be awarded the duty of care Parliament intended them to have, by other means and at the earliest opportunity;

25.5. **The Blackmore Bond case suggests that the FCA remains in urgent need of reform**. A recent episode of BBC Panorama alleged that the regulator failed to prevent consumers being defrauded of £47m; it featured a City whistleblower who demonstrated that the FCA, up to and including its CEO, rejected opportunities to collect evidence against the perpetrators by listening to them from the neighbouring office. Responding to the accusations, Executive Director for Enforcement and Market Oversight, Mark Steward, blamed Government - and investors. Challenged by TTF campaigners to justify his assertions, Steward has not yet replied, more than five weeks later. We believe that measures are urgently needed to encourage the FCA to pivot from shirking responsibility for inaction to being a proactive, transparent and accountable regulator. Note that the original headline for the article was '"FCA: DON'T BLAME US FOR THE LOST MILLIONS, BLAME THE GOVERNMENT!'" Perhaps it was the FCA that called for the headline to be changed?

25.6. **Likewise, the Woodford case suggests that the FCA is far from 'fixed'**. Just last month, the FCA announced that it was minded to approve the sale of Link Fund Solutions, the firm that stands accused of failing in its obligations to protect the interests of consumers who invested in the Woodford Equity Income Fund, if the company set aside £307m - less than one tenth of the sum lost by consumers - for potential redress and fines. The FCA appears to have no intention of removing the firm's permissions, in order to protect other consumers. This despite the fact that under its previous ownership and branding (as Capita Financial Managers Limited) the firm has been found to have failed consumers twice before, over Arch cru and Connaught. In both those cases, the FCA allowed it to continue to trade with a clean disciplinary record in return for paying partial compensation to the victims. Had the FCA removed it from the market following either of those events it would not have been in a position to repeat its behaviour in respect of Woodford, where the sum at stake was more than ten times the size of those funds combined. We understand that it is the biggest independent Authorised Corporate Director in the UK fund management sector, overseeing funds worth some £80bn, and suggest that a more assertive regulator might see this as a grossly unacceptable risk given the firm's questionable track record;

25.7. **Disturbing testimony has flooded a Call for Evidence about the regulator**. TTF provides the Secretariat to the All Party Parliamentary Group on Personal Banking and Fairer Financial Services. On 8 July 2021 we were tasked, in our capacity as the APPG's secretariat, to solicit testimony from stakeholders who'd interacted with the FCA. Around 170 responses were received - far more than anticipated. One unexpected development occurred when we were contacted by an employee of the FCA, keen to give evidence; we worked with that individual to tailor a question set to suit that group, and developed enhanced protocols to address individuals' privacy concerns. We are yet to finish collating the testimony and producing a report, however, a selection of responses are already available on the APPG website. We urge you to read them yourselves when circumstances permit.

Key concerns appear to include:

25.7.1. A track record of doing too little, too late, when faced with clear evidence of consumer detriment;

25.7.2. An apparent reluctance to enforce assertively, especially against banks and other systemically important firms;

25.7.3. Appalling treatment of whistleblowers and their evidence;

25.7.4. An organisational culture that adopts an 'FCA line' on an issue early on and suppresses dissent. Employees who challenge the official position can be bullied, marginalised, penalised or managed out;

25.7.5. Things have become worse, not better, under the current CEO.

25.8. **Our concerns appear to be shared by the new Prime Minister**. It has been reported that Ms Truss is concerned that regulators generally are at risk of capture by industry interests and are too slow and reluctant to intervene on consumers' behalf; in the context of financial services, it is claimed that she is aware of the FCA's history of regulatory failures and has floated the idea of merging it with the Prudential Regulation Authority and Payment Systems Regulator. While this is widely regarded as a bad idea[2], it is highly significant that the country's new leader has ineffective regulators in her sights and recognises that the FCA needs radical surgery. By doing so, she has shifted the Overton window materially in the direction of consumer advocates who've long called for much needed reform.

E. Our proposed amendments: introduction

26. We believe the FCA's problems are deep-seated and wide-ranging, and that it will take a capable and committed leadership team some years to remedy them. We believe it would be wrong to mandate or micro-manage the process by which that happens; rather, the role of campaigners and Parliamentarians should be to work together constructively to create an environment of transparency and accountability that incentivises local management to achieve necessary goals and provide much more effective scrutiny of performance against agreed objectives, whilst simultaneously driving up the levels of protection available to consumers should things continue to go badly wrong.

27. This approach will help rebuild confidence in the industry, reducing the deadweight loss suffered by consumers and the sector alike caused by the shortfall in trust that has resulted from the many high-profile misconduct cases, ranging from those associated with the Global Financial Crisis and its aftermath to the many investment scams that have occurred in recent years. This is a problem the FCA itself acknowledges, and is reflected by the Edelman Trust Barometer, which reveals financial services to be trusted less than any sector other than social media. The UK's financial services sector was the fourth largest in the OECD in 2021 - it is absolutely

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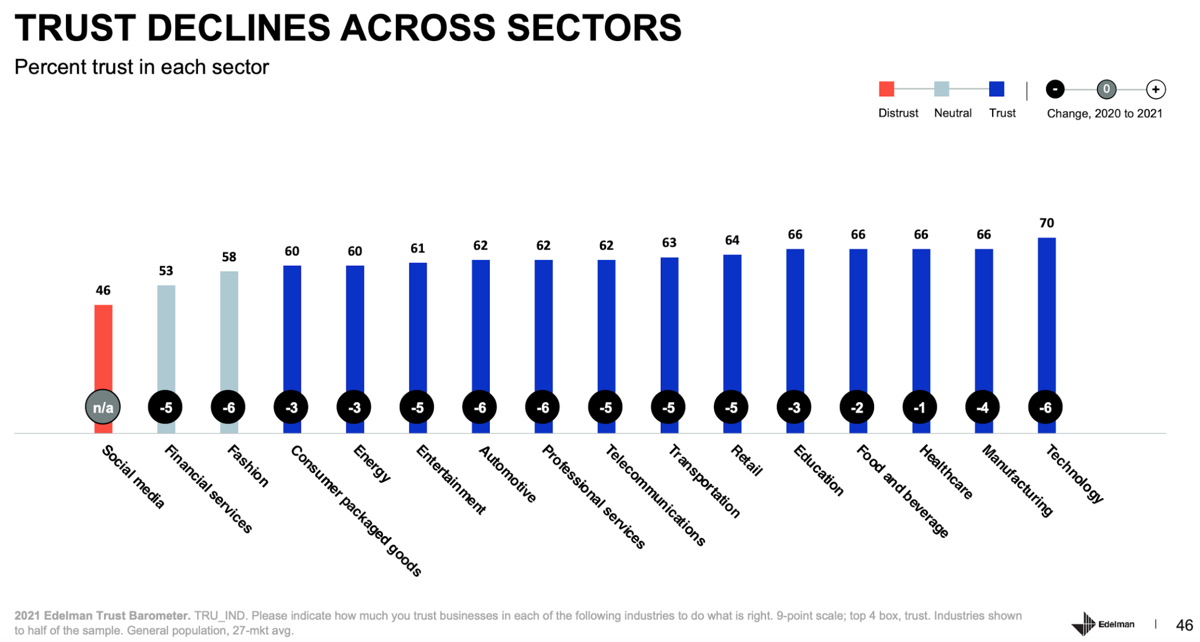
[2] It would effectively recreate the Financial Services Authority, which was abolished in 2013 following its pre-GFC failures, reimposing an intrinsically conflicted omniregulator; it would also take years to implement, and could risk exposing the currently fit-for-purpose smaller regulators, the PRA and PSR, to the flawed leadership, governance and culture of the FCA; finally, without the changes we're proposing, we fear there's no certainty that it would perform any better, especially if it continued to employ many of the same people, under the same leadership, in which case it would be likely to retain the same organisational culture and institutional memory

imperative that trust and confidence in this sector is increased both from a domestic and an international perspective



28. We believe that these objectives can be achieved by introducing the three following additional provisions to the Bill. By preference, we would like the Government to adopt our amendments, as they would thereby be more likely to pass; if not, for them to be moved by other Parliamentarians, whether in the Commons or the House of Lords. They address acknowledged lacunae in existing legislation, specifically the Financial Services and Markets Act 2000, the Financial Services Act 2012 and the Financial Services Act 2021; we believe they finally deliver and build on what Parliamentarians hoped and intended when those pieces of legislation were debated.

F. Proposed Amendment 1: Consumers should be compensated for losses caused by regulatory failure

29. **Overview** - The removal of the FCA's broad exemption from civil liability[3] and the disapplication of the Limitation Act on historic claims for the first six years after it takes effect, combined with an obligation to change its Complaints Scheme to make awards made by the Financial Regulators' Complaints Commissioner *binding* on the regulators rather than just *advisory*, and to bring the payment of redress for regulatory failure explicitly within scope.

[3] Part 4

30. **Rationale** - When FSMA 2000 was debated in both Houses, Parliamentarians clearly intended that consumers should be compensated for regulatory failures. Though persuaded to grant the regulator immunity from civil liability to save consumers having to litigate, they instead created the Complaints Scheme to provide a non-litigious dispute resolution track. Unfortunately they entrusted the regulators to write the Scheme rules and appoint the Complaint Commissioner, and made the latter's findings merely advisory. The result, according to the Commissioner herself[4] is that *'ex gratia compensation payments due to supervisory or regulatory failures on the part of the FCA will, in practice, never be available to complainants.'* Our proposed amendment remedies that, and also provides consumers with the fallback option of litigation, should it be required.

31. **Benefits** - These include:

    31.1. **Natural justice** - consumers deprived of redress will at last be able to secure it for themselves via the civil courts rather than having to wait years on FCA action (or inaction);

    31.2. **Transparency** - Parliamentarians and other stakeholders will at last have access to a crucial metric of the FCA's effectiveness (the lower its payouts for regulatory failure, the better it's doing);

    31.3. **Economic incentives** - The FCA's leadership team will be keen to do their jobs well, to avoid criticism for high levels of payout for getting things wrong. In particular, they will perform their role far more passionately, proactively and assertively, trying to cut levels of wrongdoing in the industry and, where it occurs, trying to secure redress from the industry, albeit to avoid having to make such payments itself and thus expose itself to criticism and potential reputational risk;

    31.4. **Alignment of interests** - Redress paid out by the FCA will be funded through its levy, paid by the industry. Naturally, firms would rather keep the levy as low as possible. Consequently, they will, for the first time, align with consumers in demanding more effective, assertive and accountable regulation;

    31.5. **Only way to fix the FCA** - Until the regulator is obliged to compensate those it fails, it will remain locked in a cycle of *delay, deny, deflect and defend* that obliges it to assert that its errors and shortcomings don't exist, or are

[4] Q42

overstated; for as long as that happens, it is unlikely ever to truly remedy them and this will be to the detriment of consumers of financial services in this country which of course include yourselves. We hope Parliamentarians reading our evidence to the Committee will recognise these behaviours in much of section D of our testimony.

G. Proposed Amendment 2: Governance of the FCA should be improved

32. **Overview** - To make the FCA more transparent and accountable to consumer interests, we propose the creation of a Financial Regulators' Supervisory Council ('FRSC'), an oversight body based on that already introduced in Australia following the conclusion of the Royal Commission into financial services misconduct in that country. The FRSC's principal role would be to conduct and publish periodic reviews of the regulator's effectiveness in discharging its duties in relation to consumers, though it would also commission independent reviews following allegations of regulatory failure (currently the FCA does this itself, again giving rise to concerns about *transparency*, *conflicts of interest* and *'marking its own homework'*) and appoint and oversee the Complaints Commissioner and the Directors of the Financial Ombudsman Service ('FOS') and the Financial Services Compensation Scheme ('FSCS'). We propose that the two key appointments at the FCA - those of Chair and Chief Executive, currently in the sole gift of the Treasury, would be shared between it and the FRSC. It would be funded by a one percent top-slice of the FCA's current income (note: their current Annual Funding Requirement is c.£600m not including a c.£100m overdraft facility), a move we are confident would result in Parliamentarians and the rest of society deriving far more value from the remaining 99 percent than is currently the case.

33. **Rationale** - The FCA is currently required[5] to *'consider representations'* from three Panels comprised of industry interests, and one that nominally[6] represents consumers. The Bill as drafted adds two further industry Panels, and a Cost-Benefit Analysis one that we fear may be used to make the case for lighter-touch regulation. The FCA's operational objectives[7] - consumer protection, market integrity, and competition - all have consumers at their heart, and yet the governance of the regulator has them at the very periphery, with further marginalisation planned. Evidence has also come to light in a recent employment tribunal brought by a former FCA employee who alleges constructive dismissal which indicates that the undue influence of the Treasury on the supposedly independent FCA identified by John Swift KC[8] is *not* an isolated incident, a theme also picked up from a current or former FCA employee's testimony received as part of the Call for Evidence about the FCA.

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[5] 1N-1R
[6] Its members are appointed by the FCA, and are not allowed to criticise the FCA without first clearing such statements with the regulator
[7] IB(3)
[8] See paragraph 25.3 of this paper

Creating an oversight body would provide an essential counterbalance to those pressures on the regulator, encouraging it to place consumer interests front and centre as well as ensuring greater accountability and transparency of the FCA. The entity would also remedy governance issues identified in recent years about the appointment of key positions. For instance, two of the regulator's non-executive directors were formerly appointed by the National Consumer Council ('NCC') and were intended to represent consumer interests; with the NCC's abolition, responsibility passed to the Department for Business, Energy and Industrial Strategy, weakening or severing that connection. The Complaints Commissioner has herself criticised[9] the fact that her appointment and her budget is set by the regulators whose work she scrutinises; it is right that those matters should be entrusted to a body in whom consumers can have confidence. The same logic applies to the directors of the Financial Ombudsman Service, and the Financial Services Compensation Scheme, currently appointed by the FCA. In the recent past their judgement has been questioned, in that they appointed Nausicaa Delfas and Simone Ferreira as interim Chief Executive/Chief Ombudsman and Chief of Staff respectively; both had hitherto been long standing FCA employees (going as far back as the FSA era) and had been identified in the Parker and Swift reviews as they had been the two key executives leading the regulator's Complex Events Team, known to campaigners as the 'clean-up squad', which became involved when consumer detriment had occurred but, for reasons we might speculate about, the regulator was reluctant to pass the case to Enforcement. It is right that the FOS' directors should be appointed independently of the FCA, and that the interests of consumers should be uppermost in their minds; the same applies to the FSCS.

34. **Benefits** - These include:

34.1. The FCA will be subject to significantly enhanced scrutiny, which will ultimately lead to greater transparency and accountability of the UK's sole financial services conduct regulator with regard to both financial and non-financial misconduct;

34.2. Consumers' voices will be heard more loudly and more often at the FCA;

34.3. Those whose statutory role should include holding the FCA to account will no longer be appointed by it, or by the Treasury, resolving longstanding concerns about impartiality and potential conflicts of interest;

34.4. Confidence in the regulator and the associated entities will be hugely improved, and it is likely that performance will also be enhanced.

35. **Important note** - Our proposal for an oversight body deliberately does not specify *how* its directors would be appointed. There is obvious concern that entrusting that responsibility solely to the FCA or Treasury might lead to the FRSC over time becoming captured and ineffective, but we are nervous about advancing a proposal that is outside the Overton window in terms of the power it gives to consumer

[9] Q56-59

groups (for instance, giving certain organisations the power of appointment). It may be that the optimum solution is to empower such groups, TTF included, to appoint the initial directors, then for those directors to appoint their successors as they reach staggered retirement dates, with perhaps a right of veto given to the Treasury in case the organisation 'goes rogue'. We would welcome the Committee's thoughts on the optimum appointment mechanism

H. Proposed Amendment 3: Introduce a Duty of Care

36. **Overview** - To honour the reasonable expectations of consumers raised by Section 29 of the Financial Services Act 2021[10] and resolve an issue that has been a running sore since FSMA 2000, we believe the Bill should include a clause that creates a statutory Duty of Care to be owed by authorised persons[11] to consumers[12]

37. **Rationale** - This measure would oblige firms and individuals authorised by the FCA to avoid causing reasonable harm to consumers, and would entitle the latter to monetary redress - secured, if necessary, through litigation - in the event that breach resulted in financial loss. It is materially superior to the FCA's 'Consumer Duty' in many ways, including:

    37.1. Consumers would enjoy a measure of protection even where there is no contractual relationship between them and a firm that causes them harm, provided the harm and consequent loss are reasonably foreseeable. There are many examples of this in financial services, ranging from an authorised firm that negligently or dishonestly approves a misleading promotion on behalf of an unauthorised one with which the consumer then transacts to an insurance broker that arranges expensive or poor quality insurance on behalf of a freeholder, paying an undisclosed 'kick back' to it or the managing agent;

    37.2. It would avoid the many exceptions in the Consumer Duty, such as legacy policies and contracts, usurious exit fees and other exclusions;

    37.3. The FCA would find it much easier to impose redress schemes on firms under Section 404 of the Financial Services and Markets Act 2000;

    37.4. Consumers would no longer be beholden to the FCA to secure redress for them under Section 404 or restitution under Sections 382-384 of the above Act; a Duty of Care would create a liability which they could then secure either through correspondence or, if necessary, litigation.

[10] See paragraph 25.4 of this paper
[11] The firms and individuals authorised by the FCA to conduct regulated activities
[12] 1G

38. **Benefits** - These include:

38.1. Many consumers would be entitled to redress following misconduct who currently aren't;

38.2. The FCA would find it easier to impose collective redress schemes on wrongdoing firms than is the case today;

38.3. Consumers would be empowered to bypass the FCA, which seldom enforces against firms, and secure redress through the courts;

38.4. For the first time, liability would extend to individuals authorised by the FCA, as well as to firms. Creating an environment in which there are personal consequences for wrongdoing is crucial to changing behaviour, especially given that the Senior Managers and Certification Regime ('SMCR') is hardly ever used to sanction senior managers, despite the FCA's assertions to the contrary;

38.5. The honest majority of firms would be spared unnecessarily complex red tape. The 'Consumer Duty' runs to 121 pages, and the need to review everything from marketing materials and training programmes to terms and conditions has led to a bidding war for compliance staff, driving up costs just when firms are facing inflationary pressures elsewhere and a downturn in consumer confidence. In contrast, a statutory Duty of Care could be expressed in one single paragraph, and those who avoid causing foreseeable harm to consumers - a simple test, and a reasonable expectation - would have nothing to fear from it, and no need to change their behaviour.

I. Overcoming objections

39. We anticipate that the thinking of the FCA, HM Treasury and industry may be dominated by their taking a rather defensive and short term view, and as such they may oppose our proposed amendments, failing to see how they are actually beneficial to them all in the medium to long term. Anticipating their arguments, we make the following points:

39.1. The fact that those three stakeholder groups may oppose these reasonable, pragmatic and actionable proposals to improve consumer rights and protections is *itself* evidence that the reforms are needed;

39.2. We understand that the industry (via the FCA levy) would prefer not to have to meet the costs of regulatory failure - but consumers don't want to have to either; and the industry's shoulders are broader, plus it, and not consumers, historically benefited from any tendency toward laxity in regulation. In fact, we think that there are dangers to the sector opposing the removal of the FCA's immunity from civil liability - in seeking to avoid the costs created, it is damaging the scale and reputation of UK financial services, both domestically and abroad[13];

39.3. We appreciate that there has been a wider view that civil liability imposes an undue financial burden on public law bodies. This may be arguable for an entity such as a local authority that is constrained in its ability to increase its income, which derived largely from a local population of citizens and businesses; but the FCA's income is generated principally from the industry, a much broader base. It has the power to vary the levy to meet its outgoings and, in the meantime, to borrow if its short-term funding needs change. There is therefore no scenario in which its resources or activities would be adversely impacted by the creation of such liabilities;

39.4. For the abovementioned reason we also reject the argument that the potential for civil liability would result in the FCA becoming unduly defensive and resistant to undertake actions that might give rise to liabilities. On the contrary, we believe the FCA currently suffers from a bias toward inaction[14], which we speculate has developed because it has to overcome multiple hurdles[15] if it wishes to enforce against a firm or individual, but does not face a commensurate (or, in many cases, any) challenge if it decides to do nothing, or to do very little. The potential for civil litigation would, in our view, reduce this asymmetry, resulting in the FCA becoming *more* proactive and assertive, not less, helping to remedy longstanding concerns about its reluctance to act to protect consumers and punish wrongdoing;

39.5. Some may claim that the creation of an oversight body to improve transparency and accountability in financial regulation amounts to the creation of an additional regulator, and an additional tier of red tape. This is incorrect. The proposed FRSC would *not make or implement* any regulations. The functions it would perform - reviewing the regulator's performance, commissioning independent reviews, making key appointments - all exist already in statute; in creating an oversight body, Parliament would be undertaking a tidying-up exercise, bringing those functions together in one place, and ensuring that consumer representatives would drive them, thereby mitigating the risk of conflicts of interest leading to regulatory capture;

39.6. Everything we are proposing is about *better*, as opposed to *more*, regulation - the FRSC could be seen as the FCA's 'fourth line of defence' to independently scrutinise and hold to account the FCA;

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[13] The lead author of this paper has had extensive written dialogue with the Financial Services Directorate of the EU Commission and can confirm that fear in Brussels of lax and captured regulation is a significant causative factor in the EU refusing the UK equivalence-based access to its markets. If the UK can reform its regulation such that it becomes the most effective and the most pro-consumer in Europe, access could be improved

[14] See paragraph 25.7 of this paper

[15] The internal battle to allocate resource to an investigation, followed by the need to persuade one or more of the Regulatory Decisions Tribunal, courts, the Upper Tribunal

39.7. The FCA may claim that its 'Consumer Duty' is equivalent to a statutory Duty of Care and should be given time to prove its effectiveness. We disagree. We have already demonstrated using no lesser source than the Bar Council[16] that the 'Consumer Duty' is inferior to a Duty of Care, and we know that it has created a heavy burden of additional compliance work for the industry. Moreover, at a time when ultimate responsibility for financial services regulation is being repatriated to a democratically accountable Parliament, it is surely vital that Parliamentarians send out an unambiguous message to financial regulators that *Parliament* is sovereign. Having created legislation that obliged the FCA to consult on and introduce a duty of care, and watched the regulator do something different and inferior to that, Parliament must surely therefore introduce a duty of care itself, if only to ensure that regulators understand that its writ runs throughout the nation and that no regulator is above the law.

40. We recognise that some consumer stakeholders believe that trust in the FCA has irredeemably broken down, and would rather advocate for the FCA to be abolished and replaced in some form. We counsel caution about this approach, for the following reasons:

40.1. It would take much longer to achieve, with no certainty of success;

40.2. There is every possibility that what would happen could mirror what occurred when the Financial Services Authority, minus the supervision of systemically important firms, became the Financial Conduct Authority[17] namely that the 'new' organisation consisted of mostly the same people, doing mostly the same things, in the same building, with much the same organisational culture and institutional memory, but with a different sign over the door - inessence one could argue that the FCA itself is a 'phoenixed' entity of the FSA. We believe that the consequence would be much the same as in 2013, namely a shortfall in genuine change;

40.3. There may also be significant executional and operational risks, especially at a time when staff morale has been low and employee turnover and vacancies high;

40.4. Any new organisation would surely need the improvements to transparency and accountability we are advocating, if it is to start out with the level of consumer confidence needed to succeed. Those changes can be introduced to the existing regulator, far more quickly, and with the same benefits.

41. Our role as secretariat to the APPG on Personal Banking and Fairer Financial Services in gathering and processing testimony for the Call for Evidence about the FCA[18] leads us to believe our proposed amendments address many of the concerns raised by

[16] See paragraph 25.4 of this paper
[17] Effective from 1 April, 2013
[18] See paragraph 25.7 of this paper

stakeholders who provided input to that exercise, and would enjoy widespread support from them - FCA employees present and past included. Indeed, speaking at a recent TTF event, one made the following statement in the Chat: *'As a former FCA employee of over 6 years, it is my opinion that the actions (and/or inactions) of the FCA themselves need to be supervised. The FCA demands transparency from the industry, however they themselves are incredibly opaque. Take the recent decision of not taking any action against HBOS - no reasons or justification was provided whatsoever for their decision... Furthermore, I am in favour of consumers' right of private action - in a modern democratic society every individual should be able to exercise the right to take their dispute in front of a judge and litigate against those who they believe have wronged them... Having a right of private action should also act as a "Sword of Damocles" both over the heads of the FCA as well as firms within the industry - and this should act as an incentive to act properly and at all times. Finally, I am personally of the opinion that there should be a complete delinking of the FCA and HM Treasury. It should also be looked at how appointments of the FSCS, FOS, Complaints Commissioner and the statutory business and consumer panels are made - because currently for some bizarre reason the FCA manages to appoint them and exert their influence whether directly or indirectly. The FCA is a failed and toxic organisation and is the shame of UK financial regulation.'*

42. We recognise that our proposals will not, in themselves, 'fix' the FCA. Rather, our goal is to improve the governance of the regulator and the economic incentives applicable to it and the industry sufficiently to create a more transparent and accountable environment in which, over time, the FCA will fix itself. Together, we believe our amendments represent the minimum changes needed to make that happen. We advocate them on the basis that they constitute the one credible path identified to date by which reform can be achieved consensually and at speed.

J. Further information and next steps

43. On 15 September 2022, we held a session for Parliamentarians to outline the amendments set out in this document. The video is available to watch here[19].

44. Andy Agathangelou (Founder, TTF) and Mark Bishop (lead author of this paper) are available to answer questions from Parliamentarians and the media, discuss the proposals in individual Zoom sessions and attend Parliament in person to provide further evidence to the Committee. Their email addresses are andy.agathangelou@transparencytaskforce.org and markbishopuk@gmail.com

45. We have assembled a small, *pro bono* legal team willing to help with drafting the proposed amendments, and will soon be working with supportive members of both Houses on proposed wording. We are happy to share the results of that work with the Committee or to explore whether it might be possible for the team to assist the Committee with drafting.

[19] The principal content begins at this point