Response to the FCA's Discussion Paper 18/5: A duty of care and potential alternative approaches, by

THE TRANSPARENCY TASK FORCE

November 2018

Introduction

The Transparency Task Force (TTF) is the collaborative, campaigning community, dedicated to driving up levels of transparency in financial services, right around the world. We believe that higher levels of transparency are a pre-requisite for fairer, safer and more efficient markets that will deliver better value for money and better outcomes to the consumer.

Our overall purpose is to help reform the financial services sector such that it treats customers fairly and recovers from the self-inflicted, trust-destroying reputational damage it has been experiencing in recent decades.

For further information about the Transparency Task Force see:

https://www.transparencytaskforce.org/teams-of-volunteers/

https://www.transparencytaskforce.org/about-1/advisory-board/

https://www.transparencytaskforce.org/ttf-ambassadors/

https://www.transparencytaskforce.org/transparency-times/

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We are very pleased that the Financial Conduct Authority has invited a response to its Discussion Paper on Duty of Care; it deals with ideas that chime very well with what the TTF is all about. Transparency is itself integral to treating customers fairly and under the Duty of Care any deliberate actions that obfuscate would be a de facto breach of that duty.

The contributors to this response were:

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Note that not all the participants agree with every point we make in this response; the views expressed represent the general consensus that has been formed for the purpose of this response. The TTF is all about building consensus in a collaborative and collegiate way; always revolving around our "North Star" question: "What's best for the consumer?".

Executive summary

- The TTF's guiding principle is its "North Star" question i.e. "What is best for the consumer?"

- There has been persistent widespread malpractice in financial services for many decades; the Global Financial Crisis has been the most extreme manifestation of that malpractice. Given the severity of the consequences of malpractice we wish the Regulator(s) to have as much power as necessary to ensure malpractice is minimised moving forward

- We believe there is ample evidence suggesting that a micro rules-based approach is always likely to be "after the event" whereas a principles-based approach has the potential to change the way the sector operates *systemically*

- We therefore want the FCA to introduce an over-arching principle that mandates for the behaviour we want the market to default to i.e. to care for its customers' interests

- We believe that the best way for this over-arching principle to be deployed should be through a New Duty

- We believe a Fiduciary Duty would be the best iteration of that New Duty as it would be the most potent protector of the consumer's interests due to its weight in law

- We believe the FCA should regulate firmly, consistently enforcing its rules and we do not believe it has been succesfully doing that in relation to Treating Customers Fairly

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and its Principles. We suspect that the FCA has not felt legalistically confident when malpractice under TCF and the Principles has not also been accompanied by a rule breach. The FCA has therefore been "pulling its punches"

- The introduction of a Fiduciary Duty would enable the FCA to confidently enforce its pro-consumer objectives

- The successful introduction and application of a Fiduciary Duty could enable the FCA to drive a paradigm shift in financial regulation around the world

- If the introduction of a Fiduciary Duty were likely to take time then it makes sense for the FCA to actively review its existing approach and to enforce through Treating Customers Fairly and the other Principles whilst the work to introduce a Fiduciary Duty was underway

- The FCA should work with industry bodies including professional associations and the TTF to help the sector elevate conduct towards great. "Rules to get to good and codes to get to great" could be the mantra

- The Transparency Task Force is and will remain highly supportive of any and all regulatory efforts to help protect consumers' interests; that's why we exist

The significance of the trust deficit

We believe the financial ecosystem is profoundly important to the wellbeing of society, the global economy and political stability; but there's a great deal wrong with it that needs fixing. The overall mission of the TTF is "To help Fix Financial Services by harnessing the transformational power of transparency."

This begs the question "What needs fixing in financial services?" and our response to that would be a long list of issues such as:

- The Trust Deficit
- The Engagement Deficit
- The Understanding Deficit
- Hidden costs
- Hidden risks
- Opportunistic opacity

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- Opportunistic obfuscation
- Opportunistic complexity
- Short-termism
- Inadequate client-centricity
- Asymmetries of information
- Regulatory Capture (for example in the USA)
- Scams and scandals
- A ‘profit before principle’ mindset
- Reputational damage
- Conflicts of interest
- Financial instability
- Malpractice; lack of market integrity
- Harmful incentive structures
- Miss-selling; and so on

Of all these it is perhaps the trust deficit that is most worrying because of the way it may, if left unchecked, completely corrode any remaining confidence in the sector which will lead to systemic risks that will prove to be highly problematic for regulators and policymakers to wrestle with in the decades ahead.

We think the trust deficit should be a major priority for regulators and policymakers for many reasons. For example, according to the Office of National Statistics, the UK’s savings ratio has hit a record low - just 4.9%; the lowest since records began in 1963.

The obvious question is whether the lack of trust is a contributory factor to the low savings ratio; and if so is it helping to store up systemic, toxic problems for the long term? We think so, and that gives rise to real concerns about what the worst case scenario might look like 10, 20, 30, 40, 50 years from now, particularly in relation to the possibilities of widespread pensioner poverty.

Perhaps the most useful and reliable source of evidence about the trust deficit in financial services is the Edelman Trust Barometer. For the last 18 years, Edelman has been measuring the level of trust in different industry sectors across 28 countries. The 2018 edition of their Trust Barometer is based on responses from 33,000 people. According to the 2018 Edelman Trust Barometer, the UK financial services market scores a poor 24th out of 28 in terms of how distrusting our population is as a whole. Furthermore, the Financial services sector scores a very poor 15th out of 15 in terms of general levels of trust.

It is worth noting that according to Edelman, the top 5 factors decreasing trust in financial services companies are:

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- #5 Difficulty addressing problems
- #4 Not responsive
- #3 Unwanted selling
- #2 Confusing products/services
- #1 No product/cost transparency

We think all 5 are relevant to the FCA's remit and we believe that a lack of care towards the best interests of the customer is a root cause of the many shortcomings in the financial services sector; hence our appreciation that the FCA is exploring the idea of a NewDuty.

For further information on the Edelman Trust Barometer's insights into financial services see: http://cms.edelman.com/sites/default/files/2018-03/Edelman_Trust_Barometer_Financial_Services_2018.pdf

The TTF is so concerned about what the long-term consequences of the trust deficit might be that we have been working with Newgate Communications to undertake a special study on the subject; we will share the findings with the FCA once published.

Treating Customers Fairly (TCF) when launched in 2007, was a positive step forward but could have gone much further and has been displaced in the subsequent decade; so much so that TCF has not had the conduct-changing and trust-enhancing effect it could have had. That has been a missed opportunity.

Looking forward, a New Duty, particularly if it were a Fiduciary Duty has the potential to be a very positive force in reforming financial services market conduct in a manner that will lead to better outcomes for consumers and improved levels of trust. It can help to drive the cultural transfusion that many decades of malpractice shows the sector needs.

A New Duty should lead to a different (and better) way of regulating that will positively influence behaviour, culture, ethics, market integrity and so on; all of which are of great interest to the TTF and in particular our Market Integrity Team (MIT).

The MIT was formed in January 2016 to consider how Codes of Conduct and Codes of Ethics can positively impact behaviours towards clients in the financial sector. The project involved devising and distributing a 45 question survey to fifty organisations, looking at the effectiveness of their Codes of Conduct. The results of the survey were published in a White Paper "Codes of Conduct & Codes of Ethics in Financial Services" published in July 2018 which can be downloaded here https://www.transparencytaskforce.org/teams-of-volunteers/market-integrity-team/

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Why it isn’t about a trade-off between profit and principles

It is clear that market participants sometimes fail to act prudently in relation to their two objectives of maximizing profits for their shareholders and optimizing outcomes for their customers. In the highly imperfect and terribly opaque financial services market it has been perfectly possible for companies to operate in a manner that is shareholder-centric rather than customer-centric, whilst remaining technically compliant.

We hope that an overarching New Duty, particularly if it were as robust as a Fiduciary Duty will incentivise companies and the individuals that lead them to recalibrate their priorities; placing a greater emphasis on looking after their customers’ interests.

A key point to emphasise is that in the long term it will not be detrimental to shareholder value for companies to care for their customers’ interests; in fact it will protect it and grow it. There isn’t much that is more effective at driving shareholder value in the long term than creating a company that is authentically dedicated to serving its customers interests as best as it can.

Good business practice and the consequential business uplift due to reputational advantage and a proud, purposeful and motivated workforce positively impacts the bottom line.

Furthermore, good business practice protects the organisation from regulatory fines, paid by shareholders.

The table on the next page shows the staggering loss of value suffered by shareholders of banks in recent times as a direct consequence of malpractice. We believe the table makes two points very well: Firstly, that malpractice leads to value-destroying fines that shareholders pay for. Secondly, that a micro rules-based approach to regulation without a Fiduciary Duty has been largely ineffective at preventing widespread market abuse.

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A summary of the total settlements and fines by financial institutions from 30/5/2007 to 21/7/2015

Bank	Grand Total
Bank of America	$ 57,961,300,000
JPMorgan Chase	$ 32,220,200,000
Citigroup	$ 14,847,800,000
Wells Fargo	$ 9,673,230,000
BNP Paribas	$ 8,900,000,000
Deutsche Bank	$ 4,503,500,000
Credit Suisse	$ 4,352,000,000
UBS	$ 4,015,800,000
Barclays	$ 3,648,000,000
HSBC	$ 3,473,500,000
SunTrust	$ 2,878,000,000
Royal Bank of Scotland	$ 2,186,000,000
Goldman Sachs	$ 2,176,500,000
Morgan Stanley	$ 1,910,850,000
Commerzbank	$ 1,450,000,000
Standard Chartered	$ 967,000,000
Ally Financial	$ 840,300,000
Rabobank	$ 800,000,000
ING Bank	$ 619,000,000
Bank of Tokyo-Mitsubishi	$ 573,600,000
Lloyds TSB Bank	$ 567,000,000
US Bank	$ 465,200,000
PNC	$ 416,100,000
Flagstar Bank	$ 265,050,000
GMAC Mortgage	$ 230,000,000
Lloyds Banking Group	$ 191,000,000
Bank Leumi	$ 130,000,000
Societe Generale	$ 122,000,000
Aurora Bank	$ 93,000,000
Wegelin	$ 74,000,000
State Street	$ 70,000,000
TD Bank	$ 52,500,000
RBC	$ 50,910,000
MetLife	$ 49,200,000
Everbank	$ 44,000,000
Capital One Bank	$ 38,500,000
Fifth Third Bancorp	$ 26,000,000
Liechtenstein Bank	$ 23,800,000
Sovereign Bank	$ 16,000,000
United Bank for Africa	$ 15,000,000

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Ocean Bank (Miami)	$ 10,900,000
TCF	$ 10,000,000
Union Bank of California	$ 10,000,000
Wachovia	$ 10,000,000
American Express	$ 9,000,000
Zions First National Bank	$ 8,000,000
Bank of New York Mellon	$ 7,300,000
Pacific National Bank	$ 7,000,000
AIG	$ 6,100,000
Australia and New Zealand Bank Group	$ 5,700,000
Citizens Bank (Royal Bank of Scotland)	$ 5,000,000
Doha Bank	$ 5,000,000
Pamrapo Savings Bank	$ 5,000,000
Saddle River Valley Bank	$ 4,100,000
Citizens Republic Bancorp	$ 3,600,000
Intesa Sanpaolo	$ 2,900,000
Chevy Chase Bank	$ 2,850,000
Saehan Bank	$ 2,200,000
Luther Burbank	$ 2,000,000
Midwest BankCentre	$ 1,450,000
Woodforest National Bank	$ 1,000,000
Grand Total	**$ 161,054,940,000**

Source: "Bank fines: get the data," Martin Stabe, 22 May 2015, The Financial Times Ltd. See http://blogs.ft.com/ftdata/2015/07/22/bank-fines-data/

Given the obvious value-destroying reputational damage and regulatory fines caused by malpractice in the financial sector, one would expect shareholders to actually prefer that the financial companies they invest in would operate in a manner aligned to Fiduciary Duty. On that basis we argue that it isn't about a trade-off between profit and principles; safe, sustainable profit goes hand in hand with businesses that operate with client-centric principles.

Let's remember what can happen when financial services turns bad

It would be a mistake to under-estimate how much damage can be caused when financial companies and the people that lead them fail to act as fiduciaries.

The Global Financial Crisis (GFC) is a very "good" example of what can go horribly wrong when the financial services sector loses touch with what it should be doing and quite literally fails to care about the consequences of its actions. The GFC caused tremendous harm at an individual, societal, economic and political level. Perhaps the simplest way to convey the terrible impact of the GFC is to reflect on the conclusions from research carried out by

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Oxford University in 2014 (See: https://www.bbc.co.uk/news/health-27796628) i.e. that the GFC led to more than 10,000 extra suicides. The research was carried out in 24 EU countries, the USA and Canada and it put the additional suicides down to the consequences of a far higher number of people losing their job, having a home repossessed, falling into serious debt and family breakdowns.

Beyond the tragic human cost to 10,000 people, and of course their families and friends, there is the harsh reality that the GFC has brought financial hardship to millions of ordinary people across the globe; people completely innocent of the malfeasance in financial services yet they are the ones that are paying the price. Furthermore, the inevitable reaction to measures put in place by governments in response to the GFC has impacted the world's political landscape too. One wonders how much of today's "interesting" political landscape can be traced directly back to the GFC. Maybe it explains Brexit? Maybe it explains the shifts away from the moderate centre? Maybe it explains the ascendancy of anti-globalisation and national protectionism?

Looking back, it is easy to conclude that the financial services sector has failed to address the root causes of the GFC and that weak regulators around the world have been partly complicit. We see the FCA as a regulator in ascendancy that has the potential to help lead financial regulatory reform around the world; especially if it were to equip itself with a powerful, reliable new regulatory tool – a Fiduciary Duty.

Could the GFC have been avoided altogether had a Fiduciary Duty framework been succesfully incorporated into the financial regulatory framework right around the world for the preceding 10 or 20 years?

Yes it could have; because the GFC was caused by a small number of individuals operating without care or integrity and making very bad, greed-driven decisions; all made possible by a profit-before principle culture that has prevailed in parts of the financial services sector for decades.

A Fiduciary Duty framework, if succesfully created and applied can become a significant influence on the cultural architecture of the sector. Had the right type of culture existed in the ten years leading up to the GFC the GFC would either not have happened at all or not been nearly as severe. Society would not have endured the ten austerity-dominated years that have happened since; there would be 10,000 more people alive; and the daily News would not be as troubling as it now is.

Our conclusion that the GFC could have been avoided altogether had a robust Fiduciary Duty been in place explains the importance we place on the potential for a Fiduciary Duty to drive

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the reform that is still desperately needed. Because of its DP 18/5 we see the FCA being in pole position to initiate a paradigm shift in the approach to financial regulation around the world; and we are highly motivated to support that paradigm shift in any way we can.

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Response to Questions:

Question 1

Do you believe there is a gap in the FCA's existing regulatory framework that could be addressed by introducing a New Duty, whether through a Duty of Care or other change(s)? If you believe that there is, please explain what change(s) you want to see.

Yes.

However, we note that the FCA already has a wealth of tools at its disposal that have not yet been sufficiently applied. The FCA Handbook requires firms to act honestly, fairly and in accordance with the best interests of the client. Fair treatment is a principle of the Consumer Rights Act, and client best interest rules are included in the Consumer Credit Sourcebook and will be extended under the Insurance Distribution Directive from designated investment business and mortgage activities to insurance distribution. Only by reaffirming the existing fiduciary obligation (in utmost good faith) and the Handbook can we hope to armour the duty of care owed and tackle the conflicts of interest so obviously evident today.

In this context;

1. We agree that a review and enhancement of TCF and other principles is a good starting point
2. We feel that presenting principles in a simple aide memoir is a more effective way of communicating principles than within a weighty tome of rules
3. An outcome of the MIT's survey of codes is that there are gaps in guidance and training around Codes. We agree that the FCA should publish more guidance and more case studies/examples of bad practice, and showcase good practice

However, whilst a focus on proper enforcement of the existing rules would be good use of resources, a New Duty, if carefully constructed and applied would strengthen and clarify the regulatory position thereby making it easier to apply and enforce the existing rules and where necessary provide additional powers for new enforcement measures.

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Furthermore, whilst the TCF principle is often taken into account by the Financial Services Ombudsman; only consumers that have succesfully navigated the complaints process will be benefited by it. Many people, particularly the vulnerable, will simply not have the wherewithal to succesfully lodge a complaint to the Financial Ombudsman; they will therefore not derive benefit from the TCF principle.

The FCA's principles for businesses around Treating Customers Fairly (TCF) and Conflicts of Interest do not provide sufficient protection to consumers. There have been many instances of poor treatment even though the principles have been in force for many years. Somehow, we need to bring an end to bad conduct that is deemed to be technically compliant, whereby consumers suffer but market participants are not penalised. If a company operates unfairly through exploiting information asymmetries and known weaknesses in consumer behaviour but is not challenged or prosecuted for doing so then the regulatory framework has failed.

It seems that the FCA tends to only enforce against breaches of the principles when firms have *also* broken the rules; the principles themselves seem to carry little weight. Perhaps it is difficult for the FCA to enforce against just the principles? It would seem self-evident therefore that a New Duty designed specifically to do this will help considerably; and given the international acceptance of and familiarity with a Fiduciary Duty, introducing one as an over-arching part of the regulatory architecture would seem to be a prudent next step in protecting consumer interests.

Overall, a Fiduciary Duty would synthesize diverse pinpoint regulations in to a strong investor protection baseline obligation that serves as a foundation for deterrence and compensation. We need to move from after-the-event micro rule-making to an environment that is inherently safer for the consumer.

Deterrence is served by requiring that compensation be paid because the cost of compensation incentivises behaviour modification by providers. For example, investment fund managers pay compensation to distributors and others, costing funds substantial amounts which affect fund performance and investor outcomes. All compensation payments should be justified as being in the interest of investors. Fees for services need to be earned by services actually being provided to investors equal in value to the fees paid out of their funds. No fees for no services.

Compensation should be payable for investor losses that are attributable to a failure of care by providers of financial services and products.

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We are particularly interested in your views on:

i. The types of harm and/or misconduct any changes would address.

Fiduciary is a standard to which we should all be aspiring to and the regulatory framework should mandate. Duty of Care is summarised in the Appeal Court case regarding Caparo Industries, and has three key elements:

1. A foreseeability of damage
2. An appropriate proximity of relationship
3. That it is fair, just and reasonable to impose a Duty of Care

PARTICULAR THOUGHTS IN RELATION TO THE BANKING SECTOR:

The underlying nature of the relationship between individuals and banks is such that, based on what the Appeal Court said, there should be a Duty of Care on banks in respect of not only their own customers but also anyone whose money comes into their possession as a result of fraud, i.e. the receiving bank in the case of Authorised Push Payment Fraud (APPF).

An individual's own bank should be required to have processes in place to ensure that they are confident that payments being made from the individual's account are not the result of fraud. An individual who has been the victim of fraud should have the right to make a formal complaint to, or about, the receiving bank and that bank should be required to show that the receiving account was opened and operated in accordance with the relevant regulations. The 'proximity of relationship' is, in our view, created by the receiving bank having money that was stolen from the victim of the fraud.

PARTICULAR THOUGHTS IN RELATION TO THE ASSET MANAGEMENT SECTOR:

If an investment fund manager is actually indexing the fund, then the fees paid from the fund to the manager should be based on that service, not some other more costly services such as active management. As such, a Fiduciary Duty would be an effective way to deal with the Closet Trackers problem

PARTICULAR THOUGHTS IN RELATION TO THE WORKPLACE PENSIONS MARKET:

The notion of Fiduciary Duty should be extended to the contract based workplace pensions market. This is because the provisions in COBS that supposedly mandate providers to have regard to the best interests of savers are ineffective. In practice, we would see this measure

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as hastening the rise of master trust pension schemes, which are a superior model – as they have a binding legal duty to act in the best interests of beneficiaries; a superior governance structure and lower fees. This is already taking place, with providers expecting to do less business through their Group Personal Pension and expecting their master trust to be the primary route for new business. This is because providers increasingly seeing the master trust model as a route to the resolution of legacy problems and also demand from trustees looking to consolidate into a trust based pension. As such, we see the extension of the Fiduciary Duty into the workplace pensions market as acting to hasten the inevitable in the interests of the consumer rather than bringing about a radical change in the structure of the workplace pensions market.

Fiduciary Duty is internationally recognised as the best basis on which to govern workplace pension provision. It is also the basis on which UK workplace pension provision was founded and is therefore familiar and well understood across the workplace pensions sector.

Today, there are in effect two different governance standards operating in the workplace pensions sector offering two different levels of consumer protection, with one being substantially weaker. Contract based products work less well in the consumer’s interest because the interests of shareholders dominate in a market with a very weak buy-side.

These tensions are not being resolved by the FCA’s current regulatory rules. In this context, Fiduciary Duty is a more appropriate policy tool than a Duty of Care. Duties of care speak mainly to issues of competence while fiduciary duties speak mainly to the issues of motive and incentive alignment. The policy problem in workplace pension governance is the way in which the tension between the interests of providers and the interests of savers seem to be resolved in the interests of the former. Fiduciary Duty is the most appropriate means or resolving this tension in favour of the saver.

These issues can be clearly seen in practice. Charges in the contract based sector are, on average, higher than in the trust based sector. The mean charge in a master trust scheme is 45 basis points. Charges in contract based workplace products vary but are typically higher than 45 basis points for all but the largest employers. The UK is an economy where most people do not work for large employers and therefore many pension savers will experience less financial security in old age as a direct consequence.

Various other market practices, now banned, such as active member discounts and some forms of exit charge were interpreted by providers as compatible with COBS principle six. In these latter cases, it required action by government and not regulatory action to resolve issues of consumer detriment. This demonstrates that the FCA’s present armoury is inadequate. Furthermore, there is no equivalence between trustee board and Investment

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Governance Committees (IGCs); the latter are neither independent nor governing. There has been no rigorous independent investigation into the effectiveness of IGCs and we believe them to be insufficiently robust as a regulatory lever to help reform the workplace pensions sector in the interests of the consumer.

The difficulties that IGCs face compared to a board of trustees is that:

1. Unlike trustees they do not run the scheme; they are not in the driving seat
2. The provider can appoint members of staff and people who work for other companies providing services to the provider to an IGC
3. An IGC can make a recommendation to the company running a contract-based pension scheme but the latter can decide not to follow it
4. The provider has a legal duty to maximise shareholder return and that has to be taken into account when it considers treating customers fairly, whereas trustees must place members before all other interests
5. The remit of IGCs does not extend to retirement products. In practice, these factors mean that it is the provider that decides how effective its IGC will be in driving value for money, not the IGC which decides how effective the provider needs to be in offering value for money.

It is clear that IGCs are merely advisory bodies, lacking in executive power and allowing the appointment of members with conflicts of interest. Given the FCA's statutory objective to protect consumers' interests and its interest in developing a New Duty we think the time is now right for an inquiry into the effectiveness of IGCs to be carried out; not doing so will perpetuate the material detriment that pension savers in the vast majority of contract based pension schemes are suffering as a consequence of a second class governance framework and higher-than-necessary charges.

Similar issues can also be seen in the decumulation stage. The FCA's Retirement Outcomes Review showed how charges for drawdown varied from 40 to 160 basis points for substantially the same product; an unjustifiable range. Market forces are failing to drive good outcomes.

Evidence from other countries, including the Netherlands, shows that there is a strong association between integrity and trust. Where providers are perceived to act with integrity they are more likely to be trusted than other providers. Fiduciary duty, insofar as it focuses on the beneficiary and prohibits conflicts of interest, is the obvious route to demonstrating that integrity.

The optimal model for a DC pension arrangement is trust based governance accompanied by scale. There are over 30,000 trust based DC schemes and circa 5,000 trust based DC schemes with more than 12 members. This is too large a number of schemes for schemes and trustees to be appropriately resourced to serve members. Larger schemes can more easily access better quality governance and economies of scale.

A neutral international observer addressing the first set of issues, would, if they were ignorant of the peculiarities of the UK pension system, probably be surprised that a Fiduciary Duty was not already in place. A Fiduciary Duty is generally recognised as the optimal mechanism for ensuring incentive alignment between savers and providers. Countries where workplace pension providers must operate under a Fiduciary Duty or similar include Australia, the Netherlands, New Zealand, Switzerland, and the United States.

The OECD has noted that:

"The basic goal of pension fund governance is to minimize the potential agency problems, or conflicts of interest, that can arise between the fund members and those responsible for the fund's management…"

They further suggested:

"Contract-based DC pension plans also present a major governance challenge in many countries that needs to be addressed urgently. These concerns emerge largely from the absence in such arrangements of a trustee or an equivalent governing body that represents exclusively the interest of plan members…The fiduciary responsibilities of sponsoring employers (in occupational plans) and providers (in personal plans) could also be clarified in order to ensure that the plans are managed with appropriate care and with the interest of the members in mind."

Interestingly, in Canada, most Dealing Reps (advisors) work to a suitability standard which has been compared to a car salesperson by the British Columbia Securities Commission. Efforts there are underway to try to raise this standard to "suitability Plus" albeit with dozens of opposing compensation incentives still lurking in the background; https://www.highviewfin.com/blog/the-5-elements-that-determine-whether-a-financial-advisor-is-a-true-fiduciary-according-to-canadian-courts/

ii. Whether a New Duty should be introduced and, if so, what form it should take.

As a new duty will require new legislation, a strengthening of existing principles within existing powers would seem to be a positive first step if it would improve enforcement

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capabilities. Examples quoted in DP 18/5 are an extension of the client best interest rule under Principle 6, inferring an obligation to act in accordance with clients' best interests rather than just paying them due regard.

However, it is vital that the FCA achieves its statutory consumer protection objective and to improve the chances of it doing so a New Duty should be introduced even if new legislation is required for that to be possible. A New Duty will help to clarify and strengthen the regulatory position and we think that it would:

- Significantly increase the level of protection available to consumers
- Proactively deter market participants from exploiting asymmetries of information and known consumer behaviour weaknesses
- Provided the FCA with a robust regulatory platform on which to enforce, even when specific rules have not been broken

If the lack of enforcement by the FCA through TCF and the Principles has been as a consequence of legalistic difficulties in doing so we expect a New Duty, particularly if it were a Fiduciary Duty would set the FCA free to protect consumers in the way we suspect it wants to.

We believe the New Duty should explicitly mandate for firms to pay due regard to act in the best interests of all its customers and treat them fairly; and to manage conflicts of interest fairly, both between itself and its customers and between a customer and different groups of its customers

iii. What additional consumer protection and benefit this would provide, above the current regime (including over and above the existing implied term in the CRA for reasonable care and skill).

We feel that consistently good client outcomes depend on a robust regulatory framework that leaves no 'wriggle room' for misconduct. Over and above this minimum standard of good conduct, the sector's trade bodies and professional associations should raise standards far above regulatory levels, continuously striving for excellence. We believe that voluntary codes can play an important part of that process and we therefore recommend that as well as introducing a New Duty, the FCA also explores the idea of working closely with trade bodies and professional associations and interested parties such as TTF's Market Integrity Team in the belief that Codes can play a big part in helping to raise the standard of conduct from good to great; we shouldn't be aiming for good conduct, we should be aiming for great conduct.

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iv. How a New Duty could and should act to mitigate or remove conflicts of interest, including the types of conflicts which exist in the provision of financial services?

Principle 8 and conflicts of interest should be reviewed. The introduction of a New Duty, particularly if it were a Fiduciary Duty would overhaul the way the entire sector operates. It would positively recalibrate the standards of conduct and finally deal with agency problems that meant consumers were often under the impression that the individual/organisation dealing with them was acting on their behalf when in fact the dominant driving force has been the commercial duty of the market participant to maximise shareholder value.

It's quite simple: if we want market participants to truly care for the best interests of their customers they should have to operate to a set of rules that requires them to do so; a Fiduciary Duty would be the simplest, most obvious, most robust and most effective way to do so.

v. Whether a New Duty could reduce complexity and bring greater clarity, or whether it could result in an additional layer of regulation and make it more complex, and, if so, how?

The FCA's principles and the regulatory regime through TCF, KYC, etc. already imply a strong duty of care to clients. However, there has been insufficient application of the existing rules. A New Duty should help to clarify and strengthen the regulatory position.

A Fiduciary Duty could be so clear, strong and straightforward that it would make obsolete many micro rules that would immediately become subservient to it. We imagine that once a Fiduciary Duty had been introduced an exercise could be undertaken over time to sweep away rules that were in effect obsolete and therefore unnecessary.

On that basis, a Fiduciary Duty could therefore drive simplification and streamlining of the regulatory rulebook. Furthermore, because of its overarching nature it could also significantly minimize the amount of regulatory arbitrage that exists today.

There is tremendous value in regulatory simplification, streamlining and the avoidance of regulatory arbitrage; we see this as a useful and important by-product of introducing a Fiduciary Duty.

vi. Whether other alternatives could help address any gaps, for example, extending the clients' best interests rule to different activities.

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The SM&CR regime has recently been introduced and is being extended from December 2018. This would seem to be a very powerful tool, if the rules are interpreted and invoked effectively. However, a New Duty, particularly if it were a Fiduciary Duty would clarify and strengthen the regulatory position further; buttressing SM&CR.

vii. Whether we should introduce more detailed rules and guidance, and, if so, what specific rules and guidance are required?

As stated earlier, FCA's principles and the regulatory regime through TCF, KYC, etc. already imply the requirement of a strong duty of care to clients and a New Duty can further clarify and strengthen that regulatory position.

Beyond this we encourage the FCA to work more far more closely with professional bodies to improve the outcomes in the public interest as many professional bodies already hold to account those achieving professional standards to maintain standards of ethical and professional behaviour higher than those a regulator could possibly ever set out in a single regulatory framework. If the role of the regulator is to achieve good market conduct then professional bodies can help take it from good to great.

viii. Whether the scope of any changes should differ between markets and whether it should include wholesale transactions.

We encourage a universal approach, wherever practical, to avoid regulatory arbitrage (meaning that participants gravitate to those markets with the softest regulation and/or Duty of Care).

Yes, the changes should include whole transactions. If the New Duty was being introduced to better protect consumers and drive a fairer and more efficient market then what could possibly be the rationale for not wanting the whole market to enjoy those benefits?

Question 2
What might a New Duty for firms in financial services do to enhance positive behaviour and conduct from firms in the financial services market, and incentivise good consumer outcomes?

Unless there is a cost to non-compliance, compliance becomes a matter of complacency not commitment. The bottom line for business is its bottom line. If consumers of financial services products and services are harmed by bad business practices, then they should have recourse to their providers who do not comply with FCA regulation; this way providers will experience a strong incentive to comply being applied to them and their competitors in a

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consistent and fair matter. The New Duty, particularly if it were a Fiduciary Duty would "raise all boats."

Furthermore, over and above the regulatory requirement to comply with the New Duty, we feel that the stated ethics of a business should form the foundation of its behaviour and remuneration structure, driven from the top; and hope that this may be encouraged by the FCA's SM&CR regime, particularly where sectors are not represented by professional (Chartered) bodies who can sanction members' behaviour and influence their ability to practice.

In relation to the workplace pensions market, the imposition of a fiduciary duty on workplace pension providers would certainly lead to a culture change within those providers as the balance of incentives present in firms would change. We already observe the difference in practice in the behaviour of different types of providers with respect to consumer interests and in outcomes. A duty to act in the best interests of beneficiaries would improve outcomes for consumers. This is not a hypothetical solution in the UK, we can already observe the differences as we have both sets of providers already in operation i.e. contract based pension schemes that are not required to operate in the best interests of their members and master trusts that are.

Here are some further examples of the types of behaviour a New Duty could promote:

- Currency exchange companies discontinuing the use of misleading advertising that suggests the customer will get a better rate than they actually will
- Banks providing customers with the best savings rate available to them
- Insurers discontinuing pricing policies that unfairly apply a loyalty penalty
- Banks and credit card companies only responding to requests for higher limits from their customers rather than stimulating borrowing through marketing campaigns to their companies
- The discontinuance of Closet Trackers, which we see as scandalous behaviour
- Pension companies applying much better levels of due diligence when people are transferring funds to another arrangement to help minimise the risk of pension scam fraud
- Lenders never lending beyond affordability limits
- Pension companies discontinuing the scandal of failing to provide low earners with the tax relief they are entitled to because of the Net Pay/Relief at Source scandal

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Question 3

How would a New Duty increase our effectiveness in preventing and tackling harm and achieving good outcomes for consumers? Do you believe that the way we regulate results in a gap that a New Duty would address?

The lack of enforcement by the FCA through TCF and the Principles over many years is ample evidence that there is a gap.

A New Duty would:

- Redress the balance of responsibilities between market participants and their customers
- Encourage firms to move away from 'tick box' compliance with the rules to consider how their conduct impacts consumers
- Help prevent consumer harm from happening in the first place. A good example would be in relation to how it would make banks take a more proactive, preventative approach to Authorised Push Payment Fraud; the banks would be far more likely to invest adequately in strengthening due diligence procedures and innovating better fraud-prevention systems if compelled to truly look after the interest of their customers
- Encourage companies to treat all customers more carefully, fairly and transparently; not just those deemed to be vulnerable
- Help prevent the misuse of "sophisticated investor" status as a means of reducing investor protections. We believe that the financial services industry has routinely been using "sophisticated investor" status to create a regulatory arbitrage opportunity that they have a commercial interest to exploit. We recommend the FCA look into this problem by researching investors that are deemed to be sophisticated investors; then apply some common sense to determine whether they are actually sophisticated ; and if/when the investor is deemed not to be sophisticated to unpick what the incentives were that led them to be dealt with in an inappropriate and grotesquely unfair way. The misuse of sophisticated investor status is enabling organisations that lack integrity to "drive a coach and horses" through the rules

In relation to the workplace pensions market, introducing a fiduciary duty and trustee governance for workplace pension providers would result in contract-based providers applying principles-based governance themselves. This is because unlike the FCA's COBs principles, Fiduciary Duty is directly legally enforceable. It would likely result in the FCA having to focus less on the micro-regulation in areas such as how information to customers should be disclosed, levels of charging and pension product design.

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Question 4

Should the FCA reconsider whether breaches of the Principles should give rise to a private right for damages in court? Or should breaching a New Duty give this right?

The New Duty should include a private right of action for compensation in case of breach of their obligations. It is unhelpful to leave the formulation of a duty to the courts. A breach of a regulation does not automatically or axiomatically give rise to a cause of action for damages in tort. To the contrary, a breach of a regulation may, not must, amount to a failure to comply with the standard of care of an industry participant. But the breach of a standard of care does not equate to the existence of a Duty of Care.

A Duty of Care is found by the operation of loose principles of law relating to proximity and policy.

Proximity is the legal concept referring to the foreseeability of harm on the part of a defendant in relation to the act or omission alleged against it.

Policy is a legal concept providing that a duty of care may not be imposed where the consequence would be an un-economic imposition of risk/cost on a defendant that does not have the means to manage the risk.

These are concepts that are developed in law and economics. They may be applied in formulating the regulatory New Duty.

In relation to the workplace pensions market, if a Fiduciary Duty were imposed on contract-based providers then their customers would have the right of redress through the courts. This is well understood in the context of pensions and there is a large advisory industry capable of supporting providers in handling it. Indeed, many providers also operate a master trust pension scheme and are already exposed to this risk.

Question 5

Do you believe that a New Duty would be more effective in preventing harm and would therefore mean that redress would need to be relied on less? If so, please set out the ways in which a New Duty would improve the current regime.

Yes, for all the reasons given this far, the New Duty would incentivise compliance and therefore reduce the occasions of investors calling for redress.

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Furthermore, because Fiduciary Duty is principles based and directly enforceable by individuals, the principles do not need to be turned into detailed rules in specific areas by the FCA before it has any effect.

In our view, by pursuing behavioural micro-regulation targeted to specific problems, the FCA is always one step behind the problem. Where providers have an institutional structure that encourages rent-seeking and there is weak buyer power, abuse will continuously reoccur in new forms as markets innovate. The term "regulatory whack-a-mole" comes to mind.

The problem with this for the market as a whole is that it allows the continuance of misconduct, malpractice and malfeasance; all of which damages the very trust that the sector needs to function effectively. As the FCA noted it in its recent investigation into retirement outcomes, the pension industry is highly mistrusted; but so too are many other parts of the financial services sector. Low levels of trust leads to poor take up; for example low levels of pensions saving. So not only does malpractice harm consumers it harms the long term commercial success of the sector as well.

Other considerations

We set out below some thoughts beyond the scope of the specific questions given that we hope might be useful. We think there may be value when the New Duty is formulated to give consideration to key questions, such as:

- Is regulatory enforcement sufficiently robust? Perhaps existing powers are not being utilised as intended? Has the FCA failed to make good use of the existing powers it has had? Why has TCF and the Principles failed to make a material difference when they should have. Would financial regulation be more effective if the FCA were itself more accountable? If the FCA does create a New Duty is there a danger that it will fail to make full use of it to protect consumer interests?
- Are fines and sanctions acting as general deterrents? Perhaps punishments have been too light, with too much malpractice going completely unpunished?
- Are complaint handling processes transparent and fair?
- Should the FOS compensation limit be substantially increased?
- Are conflicts of interest disclosures effective?
- Are regulations regarding marketing and advertising being effectively enforced?
- Is the KYC process collecting accurate and complete information? For example, many investors have values-based preferences that are not discovered during the fact-

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finding process (such as not wanting to invest in a manner that harms the planet). As a result they invest in a manner that is not in keeping with their beliefs

- Has the term “advice” been adequately defined? Are consumers able to easily differentiate between when they are being given information v guidance v advice?
- What more can be done to help consumers benchmark whether they are receiving value for money?
- Do market participants clearly articulate to consumers such that they understand their rights and the scope/nature of the services they are paying for?
- How can the power of technology be applied to better-protect consumer interests?
- Could the idea of minimum standards of financial inclusion and education for consumers be brought into the regulatory perimeter, on the basis that an unaware consumer is a vulnerable consumer
- It will be very important for the FCA ensure that the exact nature of the Duty of Care/Fiduciary Duty/New Duty is very well communicated with clear and unambiguous definitions plus worked examples, so that there will be no confusion about what is expected of market participants moving forward; and the FCA can enthusiastically enforce the rules to those that do not comply
- How might the thinking behind having Independent Directors on boards of asset managers as a means to protect the interests of customers be applied in areas beyond asset management?

Conclusion

Our current regulatory framework does not provide adequate protection for consumers because current regulation has not yet delivered the change required. The extent and longstanding nature of consumer detriment indicates that cultural change is required within firms and the market as a whole.

The existing Principles do not remove conflicts of interest and do little to deter firms from mis-selling products and services.

Furthermore, once poor conduct is found, consumers have to face a lengthy battle to obtain redress. If firms had a legal duty of care to customers, it would help achieve better outcomes in the first instance

The New Duty could operate as a preventative measure to protect consumers, obliging providers of financial services to avoid conflicts of interest and act in customers’ best interests. A New Duty would promote responsible behaviour on the part of businesses,

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ensuring fairer outcomes for consumers (particularly the vulnerable) and an improvement in firm culture.

Given that the FCA has a responsibility to consider and be open to alternative approaches that might address stakeholders' concerns we believe the FCA should now move forward with introducing a New Duty and we propose that the New Duty should be a Fiduciary Duty as that would provide the consumer with the greatest protection from a sector that has been predisposed to malpractice and a profit before principle mindset for decades.

We thank the FCA for issuing DP18/5 and are appreciative of the opportunity to share our thoughts through this response and any subsequent dialogue we might be invited to participate in.

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