Financial Inclusion Commission – Written evidence (SCG0065)

Lord Grabiner requested that you respond in writing with any criticisms of the FCA's current approach to implementing the Consumer Duty (Q. 317, pg., 12). More broadly, what actions could the FCA take to realise the benefits to customers and firms offered by the Consumer Duty as it continues to be embedded in Financial Services?

More assertive supervision and enforcement

It's now 18 months since the Consumer Duty came into force, and the FCA's approach to implementation has so far been relatively light touch. Early on, the regulator took actions which sent clear messages to the industry that this was a step change in regulation and could have serious consequences for those who didn't step up to the new requirements. Early last year, it took strong action against a niche insurance sector (GAP insurance) effectively temporarily closing the sector down because it had not responded appropriately to the Consumer Duty. It also warned investment platforms about failing to offer fair value to those who hold cash balances in their accounts.

However, many investment platforms did not respond to the FCA's calls to improve cash rates, and other niche insurance sectors have not heeded the warning that was sent by its action in the GAP insurance sector. Meanwhile, the FCA has been less able to respond as vigorously as some would like to apparent failures to observe the Consumer Duty, perhaps sending a message to firms that the regulator is less than serious about implementing and enforcing the Duty.

There is much that the financial industry can do to set standards without waiting for regulatory action. I referred to the role of voluntary self-regulation during the session, whereby firms agree to comply with standards which go beyond what they are required to do by statutory regulation. The Consumer Duty reinforces this by requiring firms to prove they are acting to deliver good outcomes. In doing so, it creates a perpetually rising tide - as front runners show what is possible and are commended as embodying best practice. But for firms to take it seriously, the FCA needs to make clear that flouting these rules can have real consequences. By keeping Consumer Duty front and centre of their communication and all policy work they are doing, they will ensure that consumers realise the benefits. The initial push has led to dozens of fees, charges and commissions being cut - as well as thousands of communications being rewritten. But there is much more to be done. I understand that the FCA's enforcement tools can be unwieldy, but the regulator has a range of other tools at its disposal, including the

appointment of skilled persons to conduct reviews, the variation of firms' permissions, the power to ban products and the power to publish details of misleading financial promotions. I hope that we will see the FCA using all the tools available to it to ensure that the financial industry embeds the Consumer Duty.

Guidance and feedback

The FCA has provided a large volume of general guidance to firms to support the Consumer Duty rules as well as more specific feedback to the various subsectors which the FCA is responsible for supervising. We would encourage the FCA to continue to provide this level of guidance and feedback, addressing areas in which firms have questions about the application of the Duty. Our assessment is that the Consumer Duty has already had a substantial and positive effect by refocussing many firms on delivering good outcomes for their customers and enabling the FCA to act against some of the most egregious practices which had persisted despite the Treating Customers Fairly regime.

An open debate about financial inclusion

The Financial Inclusion Commission has argued over time that the FCA should have regard to financial inclusion and we we welcomed the recent Remit Letter which required it to do so. In the area of financial inclusion, the Consumer Duty brings three questions to the fore:

- Does the regulator accept that the provision of some financial services to low-income groups may not result in good outcomes for a minority of people, although the majority will benefit from increased access? This is a particular issue in unsecured consumer credit, where lending by responsible organisations to low-income consumers may result in higher default rates even though most people who obtain credit are able to repay.

- Does the regulator accept that lending to this demographic does require the charging of relatively high interest rates, given the higher probability of default, and that these higher rates are consistent with the "fair value" requirements of the Consumer Duty?

- What can the FCA do to encourage firms to deliver better understanding by customers of their financial decisions? Despite the Consumer Duty, many firms still rely on extensive and small print terms and conditions to protect themselves rather than engaging wholeheartedly with the requirement of the Consumer Duty to support their customers' understanding. There is great potential to address the relatively low financial capability of the UK population by requiring customer journeys which present easy-to-understand

information and relevant information at the point of decision. We have not yet seen the FCA realising the full potential of this aspect of the Duty.

- We welcome the development of community banking hubs and would like to see these also being tasked with supporting digital inclusion and improving consumer financial capability with a focus on improving equity investment participation.

We would support the FCA hosting an open debate about the application of the Consumer Duty in underserved markets, in order to give firms confidence to act in those markets. Any such debate would need to include the Financial Ombudsman Service.

Lord Hill noted your comments on the Consumer Duty permitting a simplification of regulatory rules, such as the FCA Handbook (Q. 317 pg., 12), and requested you suggest specific rulesets that could be simplified in this way (Q. 319, pgs., 15-16). Noting also that the FCA is currently conducting a review of its Handbook, what wider changes in the regulator's approach to using prescriptive rules would benefit consumer outcomes and growth in the sector?

Considering other specific regulatory changes that might increase investment in the real economy, I suggested that there might be areas where some housekeeping might allow rationalisation of existing rules rendered less relevant once the Consumer Duty is fully embedded. However, we are not convinced that a substantial exercise of rewriting the FCA's rulebook will bring benefits that justify the effort in the short term. Instead, we suggest that the regulatory reform work should focus on areas where the UK is underserved, including the following:

- Identity any anti-money laundering requirements that make it hard for some people and some small businesses to open bank accounts and access other essential services

- The application of affordability rules in the consumer credit sector, ensuring that the Consumer Duty and affordability rules do not prevent responsible lenders from serving low income consumers in that market. Pivoting the UK away from a focus on Credit Scores to Financial Resilience Scores and the introduction of an impact assessment for both government and regulators that tests the impact of financial resilience of a proposed change

- Ensuring that regulatory barriers to workplace savings schemes are removed. We support the development of 'sidecar savings' and would like to see its scope going beyond the accumulation of an

emergency savings pot and embracing the building of an investment portfolio.

- The continuing work on the boundary between advice and guidance, to ensure that people can access the help they need to answer money questions. This should be supported with an overhaul of the MAPS-owned UK Financial Capability Strategy to put greater focus on equity investment. MAPS' MoneyHelper Service might usefully be rebranded as the MoneyAndInvestmentHelper

- FCA should review the Bundling Payments Rules to remove the unintended impacts that reduce consumer financial resilience such as removing the barrier that prevents registered landlords providing their tenants with contents insurance and including the premium within rent payments.

- Supporting the development of both Open Banking and Open Finance, to equip people with tools to manage their money better. We would welcome greater HM Treasury and FCA support for Open Banking development.

In the longer term, the issues which have become apparent in the motor finance market show that the multiple layers of financial regulation – FCA rules, statute, common law and the Financial Ombudsman Service's "fair and reasonable" jurisdiction – create a complex environment for businesses and consumers. Now that the Consumer Duty is in place, it may be worth considering whether some of these layers should be simplified or removed.

Further rationalisation could be achieved by coordinating the identification and support of vulnerable customers across all UK regulated sectors including financial services, energy, water, gas and telecoms to reduce firm costs whilst improving vulnerable customer support. This approach, as recommended by the Money Advice Trust, would also generate cost-savings for firms through shared training programmes.

In response to Lord Lilley's request to provide specific regulations that, if changed, would increase the amount of investment into the real economy (Q. 321, pg., 20), you undertook to respond in writing. Please share examples that next to the proposed pensions reforms, noted in the session, would have the greatest impact".

I have outlined my views on measures that might increase productive investment through specific regulatory changes. During the evidence session, I mentioned the potential for pension reforms to facilitate greater investment in productive assets. The biggest immediate impact in terms

of getting more Defined Contribution funds into growth assets would be to reduce or eliminate the use of 'lifestyling' in which there is programmed de-risking of the DC funds for members in the years leading up to retirement. It has been estimated that this reduces the investment return to members by about 2.3% per annum and that the estimated boost to capital markets could be as much as £10-£25 billion.

According to the Pensions Policy Institute only about 15% - 20% of members' assets are in bonds until lifestying typically cuts in but, after lifestying, the proportion in bonds rises to an average of around 55% before retirement.

Pensions are, perhaps, the most complex aspect of people's financial management challenges, which is why the Commission welcomes the success of Pension Wise, for those who access it, but why we regret that more people do not do so.

Both Which? and the Institute for Fiscal Studies have pointed out that a majority of those who access their pension plans for the first time withdraw their pot in full, meaning that much of the funds that might otherwise be invested in productive assets find their way into household consumption.

The case for mandating a Pension Wise appointment needs to be revisited, and the quality and accessibility of the information given by pension providers to people seeking to access their pension funds should be examined. Better financial understanding amongst people in the UK reaching retirement would be likely to lead (to their benefit) to fewer retirement funds going into cash and more into growth assets.

29 January 2025