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Rt Hon Nicky Morgan MP
Chair of the Treasury Committee
House of Commons
Committee Office
14 Tothill Street
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20 February 2018

Dear Nicky

Re: Follow up to the Treasury Committee 7 February 2018

At our hearing on 7 February 2018, I said that I would write to you to provide information on a number of issues.

Motability

Mr Mann raised recent press reports in respect of this firm, which focused on executive pay and cash reserves. Mr Mann has now written to me with some further questions regarding Motability in the context of the joint Treasury Committee and Work and Pensions Committee inquiry into Motability and we will respond to these queries in full in a separate letter.

Role of the Financial Ombudsman Service

In relation to our recent paper on SME redress[1], Mr Mann asked whether or not it would be appropriate for the Financial Ombudsman Service to reopen and re-examine complaints were there to be a strengthened ombudsman role and a higher award limit available, noting a similar step taken by the Legal Services Ombudsman in 2008.

I have considered this and I do not believe there was a precedent set for reopening cases in order to reconsider their merits under a revised scheme. I am confident in the outcomes that the Financial Ombudsman Service produces. I have set out the structure below to illustrate why I believe this to be the case.

Up until 2010[2], if a consumer was unhappy with the service they received from a lawyer, they would complain first to their lawyer. If they remained dissatisfied with the response, they could then complain to the Legal Complaints Service, the complaints handling function of the Law Society. The Legal Complaints Service would look at the merits of the case, and award compensation if appropriate. If a consumer was dissatisfied with this outcome, they could take their complaint to the Legal Services Ombudsman. The Legal Services Ombudsman could consider how the Legal Complaints Service handled the case, and if it felt the case was not handled correctly, could direct the Legal Complaints Service to reinvestigate the complaint. The Legal Services Ombudsman could not consider the merits of the complaint against the solicitor.

[1] https://www.fca.org.uk/publication/consultation/cp18-03.pdf
[2] The Legal Services Act 2007 created the Legal Services Ombudsman, which took effect from 5 October 2010, removing the need for consumers to complain to a professional body after having complained to their lawyer.

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This complaints structure existed in the context of a profession which, at the time, faced problems in the handling of complaints. As a result, in 2004 the Government appointed a Legal Services Complaints Commissioner, with responsibility for working with the Law Society to improve its complaints handling.

In the specific matter to which Mr Mann referred, the Coal Health Compensation Schemes, the Legal Complaints Service attracted significant criticism from the Legal Services Complaints Commissioner. This was informed by a number of MPs on behalf of their constituents, as well as individual complainants. The Commissioner made recommendations to address the widespread inconsistencies in complaint handling identified in its audit of cases. The exceptional cases heard by the Legal Services Ombudsman were sent back to the Legal Complaints Service to re-examine.

There are some fundamental structural differences between that complaint structure and the structure we have today in financial services. The Legal Services Ombudsman had the power to direct a separate body to reinvestigate complaints that were not handled appropriately. I view this as substantially different to asking the Financial Ombudsman Service to reinvestigate its own decisions in response to an extension of its remit or changes to its powers.

The Financial Ombudsman Service will consider the merits of a complaint and can make an award based on what it believes to be fair and reasonable, and based on the rules which applied at that point in time. If the Financial Ombudsman Service considers the financial business did not handle a complaint effectively, it can also consider awarding additional compensation for any distress and inconvenience caused to complainants. A final decision made by an Ombudsman is legally binding on the financial services firm (assuming that the consumer has accepted it), and therefore provides finality to all parties. Once an Ombudsman has reached a final decision, they have no further role in the matter. Furthermore, I do not think it would be fair to require firms to reopen cases and pay more redress, for example, where a case had already been settled and accepted by a final decision in the past.

If we were to amend the scope or award limit of the Financial Ombudsman Service, we would make clear when these changes take effect, and therefore which complaints are subject to them. For example, in our consultation paper on SME access, we propose that any changes to the Ombudsman Service's jurisdiction will apply only to complaints made to a firm for its actions or failure to act that occurred on or after 1 December 2018. However, should we make further changes to the Financial Ombudsman Service in the future, our rules could allow an increased award limit to apply to complaints referred to the Financial Ombudsman Service after the limit was increased, even if the complaint referred to an act or omission that occurred before the change.

Failure to prevent offence

Ms McKinnell asked for our view on whether the "failure to prevent" offence model should be extended beyond, for example, the Bribery Act's requirements, to cover economic crime more generally, and whether this would assist the FCA.

We feel that, because of the powers we hold, there is less of a "justice gap" within the financial services industry than is perceived to exist in other sectors. The failure to prevent model seeks to overcome the obstacles presented in other sectors by the identification doctrine, which determines corporate liability for both civil and criminal wrongs carried out by agents and the servants of the company in common law. This doctrine can make it difficult for prosecutors to find companies guilty of some serious crimes, especially large companies with devolved business structures. However, the range of regulatory powers which we are able deploy including the Senior Manager & Certification Regime, mean that we do not face the same issues holding individuals and firms to account.

Seeking to run a failure-to-prevent-type offence in parallel to the Financial Services and Markets Act's regulatory regime would pose a number of challenges and we would need to request that the extension apply also to criminal offences in FSMA for which the FCA has primary jurisdiction.

De-risking

During the session, I said that there was no consistent map of data in relation de-risking. I want to set out what we have done to understand the nature and scale of the problem and how it affects business sectors, including charities that have issues with access to banking.

De-risking is a global issue relevant to financial markets worldwide. We are working with HM Treasury to support work related to de-risking by international agencies such as the Financial Action Task Force and the Financial Stability Board.

Within the UK, it is important to remember that banks have the commercial freedom, subject to some restrictions, to choose who they do business with. A range of factors can influence de-risking decisions, including credit risk, profitability, reputational risks and the bank's ability to manage legal and regulatory requirements related to anti-money laundering and financial sanctions compliance.

Two years ago we said publicly that a risk-based approach does not mean that banks should deal generically with whole categories of customers or potential customers. Instead, we expect banks to recognise that the risk associated with different business relationships in a single broad category varies, and that they should manage that risk appropriately. But we also made clear that, where a bank does not believe that it can effectively manage the money-laundering risk associated with a business relationship, it should not enter into or maintain that business relationship.

At the end of 2016 we announced a financial crime data return. This is completed by larger firms subject to the Money Laundering Regulations, including all UK-authorised banks, and asks firms how many customer relationships they have either refused or exited because of reasons related to financial crime. Data gathered during 2017 shows that 237,000 customer relationships were ended for such reasons across the entire financial industry (which maintains over 400 million customer relationships in total). Many of these will have been because of fraud concerns, rather than money laundering risk. This aggregate figure does not tell us, however, how well these decisions are being handled: we have performed other work to gain an understanding of that question.

Also in 2016, we commissioned and published a report that looked at all sectors we understood had been affected by de-risking, including the charities sector. This was shared with the Committee at the time. The report found some banks were closing accounts for charities operating in geographical areas perceived to present greater money laundering and terrorist financing risks. However it was not possible to establish exactly how many charities had lost access to bank accounts, mainly because banks did not collect this information. Where information was available, we noted that, in one bank, of the 2,500 charity bank accounts closed in 2014, only 59 were closed for reasons that might relate to compliance concerns.

Since we published that report, we have been working with the banks through UK Finance to develop a set of principles to improve how banks communicate with customers when they cannot offer, or continue to provide, banking facilities. UK Finance are due to publish these principles in the next few months and we expect them to emphasise that banks should:

(i) treat customers fairly and communicate in plain English;
(ii) assess existing and prospective relationships on a proportionate, objective and non-discriminatory basis; and
(iii) engage with the customer, as appropriate, before reaching a conclusion.

Access to Insurance

You asked whether we were doing any work in relation to access to insurance products for those with disabilities. We published a Call for Input (CfI) last year looking at access to insurance as part of our ongoing work on access and vulnerability. This focused specifically on access to travel insurance for those with cancer but we were clear that there is a broad read across from access issues experienced by those who have, or have had, cancer and other pre-existing medical conditions in both travel insurance and other protection products.

In particular, we wanted to understand how consumer outcomes can be improved in this area, whether by traditional methods or innovation. We also sought views on whether our regulatory framework affects innovation and how we could support industry in ensuring consumers' current and future needs were met appropriately.

Since the CfI closed, we have been analysing responses and considering whether some practices hinder the ability of those with cancer or other medical conditions or disabilities getting access to appropriate cover and what we might be able to do to improve the picture in this regard. We expect to publish a Feedback Statement early in the summer which will set out our findings and our proposed remedies in detail.

Contracts for Difference

Mr Hammond asked for information regarding the total number of consumer complaints we have received in relation to Contracts for Difference (CFDs) sold to retail clients in the past five years.

It is worth noting that, under FCA rules and European law, a consumer's first recourse for a complaint related to a regulated firm's investment services, such as providing CFD trading, is to raise it with the firm. Our data indicate that firms representing over three quarters of the UK retail CFD market received 10,376 complaints over the last 5 years in relation to investment business, 1,190 of which were upheld by the firms. Before 30 June 2016, firms were not required to report complaints resolved by the close of the next business day following receipt[3].

Where complaints are not resolved by the firm (either because the firm has exceeded the required timeframe or the client is dissatisfied with its response), consumers have the right to escalate their concerns to the Financial Ombudsman Service. The Ombudsman records complaints in relation to CFDs as either 'derivatives' or 'spread betting' products. There were a total of 1,818 complaints escalated to the Ombudsman in these two categories between Q1 2013 and Q4 2017. 460 of these complaints were upheld over this period.

We do not, however, consider that consumer complaints data give a full picture of the harm that CFDs pose to consumers. For example, investors may not receive compensation for trading losses, unless they were incurred due to errors by the firm such as a breach of the terms and conditions of the contract or the provision of misleading information.

CFD products are commonly distributed to the mass market despite being complex, high risk derivatives. Our supervisory work has identified significant investor protection concerns. Data from our 2015 thematic review showed that 82% of clients trading these products on a non-advised basis lost money, with the average outcome per client being a loss of £2,200. We also found significant shortcomings in firms' appropriateness tests, which are intended to assess whether a client has sufficient knowledge and experience to understand the risks of a particular product prior to investing.

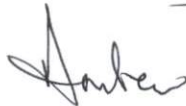
[3] We introduced new rules on the reporting of complaints in our Policy Statement 15/10, Improving complaints handling, feedback on CP 14/30 and final rules https://www.fca.org.uk/publication/policy/ps15-19.pdf

Our more recent review of firms offering the product to retail investors through advisory and discretionary portfolio management arrangements between July 2015 and June 2016 found that 76% of clients lost money and that the average client outcome was a loss of £9,000. Similar percentages and scale of losses have been reported in studies conducted by regulators in other jurisdictions.

We continue to work closely with ESMA and other National Competent Authorities as ESMA considers responses to its Call for Evidence[4], which closed on 5 February 2018, on possible product intervention measures.

I do hope that you find this information helpful.

Yours Sincerely



Andrew Bailey
Chief Executive

[4] FCA, "Providers and distributors of contracts for difference (CFD) products: resolving failings which may cause significant consumer harm," 10 January 2018. See: https://www.fca.org.uk/publication/correspondence/dear-ceo-letter-cfd-review-findings.pdf.