HOUSE OF LORDS

HOUSE OF COMMONS

ORAL EVIDENCE

TAKEN BEFORE THE

JOINT COMMITTEE ON THE DRAFT FINANCIAL SERVICES BILL

THURSDAY 15 SEPTEMBER 2011

DR MALCOLM EDEY

CHRISTINE FARNISH, PETER VICARY-SMITH, GILLIAN GUY, MARTIN LEWIS and PAUL LEWIS

MARK NEALE, NATALIE CEENEY and TONY HOBMAN

Evidence heard in Public Questions 99 - 206

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Oral Evidence

Taken before the Joint Committee on the Draft Financial Services Bill

on Thursday 15 September 2011

Members present:

Mr Peter Lilley (Chairman)
Mr Nicholas Brown
Baroness Drake
Mr David Laws
Lord Maples
Lord McFall of Alcluith
David Mowat
Mr George Mudie
Lord Newby
Mr David Ruffley
Lord Skidelsky
Baroness Wheatcroft

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Examination of Witness

Witness: **Dr Malcolm Edey,** Assistant Governor (Financial System) of the Reserve Bank of Australia, examined.

[This evidence was taken by video conference.]

Chairman: Dr Edey, thank you very much indeed for joining us from Australia. We are grateful to you and are very interested to hear the experience of your country.

Q99 Baroness Drake: Dr Edey, Australia weathered the global financial crisis well compared with the UK. That certainly seems to be the common view. To what extent in your view was this due to proactive regulation in Australia, and to what extent was it due to the particular characteristics of the Australian financial markets?

Dr Edey: It is true that Australia did well during the financial crisis. We did not have a recession, bank failures or the need for public funds to be injected into the banking system. I am often asked for the explanation for it. My usual answer is that it was a mixture of good luck and good management. The good luck side of it is that Australia is fortunate to be closely integrated with the Asian economies which performed better than the United States and Europe over recent years. We have been benefiting from a commodities boom here, and that has been very important to our performance. Certainly, that has not been the sole driver. I think we have been well served by our prudential regulatory system. As you probably know, Australia has a regulatory model quite similar to the UK's, so we have a prudential regulator separate from the central bank. I think our prudential regulator served us well. They had a

fairly tough-minded approach to setting standards in a number of respects. They set tougher capital standards than were applied to banks globally, and I think they also had a more proactive approach in using their discretion to resist unsound practices.

There are other factors behind Australia's performance. I think the fiscal position of the Government coming into the global crisis was very strong and allowed plenty of scope for the Government to engage in a counter-cyclical fiscal policy to cushion the effects of the crisis. The Reserve Bank was fairly proactive in keeping up the level of interest rates in the boom times heading into the crisis, which meant we had a lot of room to manoeuvre in cutting rates when the global economy turned down. A whole series of things contributed to the overall performance.

Q100 Baroness Drake: Did the agreement between the banks not to take each other over have a significant behavioural effect on them?

Dr Edey: I am not sure what you mean by the agreement not to take each other over.

Q101 Baroness Drake: I may be wrong, but my briefing said there was an understanding between the banks, not necessarily enshrined in law, that they would not take each other over or take predatory action against each other. Is that not correct?

Dr Edey: We have a policy here which we refer to as the four pillars policy. Australia has four major banks which together have about three quarters of the market in banking services in Australia. The Government's policy for some time has been not to allow takeovers to occur among that group of four, which would further concentrate the system. I think that is what you are referring to. Would you repeat the second part of the question?

Baroness Drake: To what extent did the existence of that policy have a significant impact on the behaviour of the banks—

Q102 Chairman: —in reducing their incentive to compete with each other by over-lending, operating on lower capital requirements and so on? Was there less incentive than there might have been had they been trying to ramp up their share prices and profitability to take each other over, or avoid being taken over?

Dr Edey: Yes. There is probably something in that. I would not say that our system was completely uncompetitive, but some commentators have made the case that the Australian banks were not as aggressive in competing for market share, for example by lowering their lending standards, as was the case in some other countries. I think there is something in that argument.

Q103 Chairman: Perhaps I may add a follow-up to Baroness Drake's first point about the underlying causes of your greater stability. In America, the UK and some parts of Europe the banking crisis was related very much to a prior lending boom in housing, driving up housing prices. When the house price bubble collapsed it led to problems for the banks. Was there a similar housing bubble in Australia? Were efforts made to puncture or moderate that bubble earlier than in Britain and America? Can you tell us a little about that aspect of the situation?

Dr Edey: We had our housing boom in about 2002-03. If you look at a graph of Australian and UK house prices they look very similar during that period, but, unlike the UK, we really did not have a follow-up boom during 2006-07. In Australia during 2002-03 the regulators saw that as a source of risk to the financial system and the economy. We took some steps to try to rein that in. Probably the main thing the Reserve Bank did was to make public statements to try to warn people of the risks, but it was also a period when we were raising the

policy interest rate. That also played a role in helping to take some of the heat out of the market. At that time APRA was also aware of the risks in that area and of using the powers available to them to discourage banks from excessive expansion. That was one of the reasons why a few years later we did not get into so much difficulty during the global downturn because the main boom in house prices in Australia was further in the past and there was not so much overstretch left over by the time we got to 2007-08.

Q104 Lord Newby: Dr Edey, you described how good management played a significant role in avoiding some of the worst problems that we had here in the banking crisis. How much do you think that was due to the regulatory structure itself and how much to the ethos and wisdom of the people operating it?

Dr Edey: My feeling is that it is more the second one of those. I do not want to say we have better people than other countries, but the regulatory culture in Australia may have been different from the one that prevailed in other countries. In financial regulation, particularly prudential policy, there are laws that stipulate what banks can and cannot do, but there is also a lot of soft power available to the regulators to influence the way the institutions that they regulate will behave. Some regulatory cultures are more comfortable than others with making use of those softer powers.

In Australia APRA would describe itself as being towards the end of the spectrum; that is, it would be more comfortable with using its persuasive powers and ability to put pressure on institutions to try to influence the way they behave. It is important for prudential regulators to be able to ask tough questions of institutions about the risks that they take and not take too mechanistic and legalistic an approach to the way they regulate. APRA was probably more towards the end of the spectrum that was comfortable in taking that sort of approach.

You might ask why APRA has that characteristic. One reason for it is that very early in APRA's history we had a significant failure of an insurance company called HIH, which was one of the major insurers in Australia. There was subsequently a royal commission into what went wrong and all the various ways in which the institution itself got into difficulties, and how the regulator missed seeing that until quite late in the process. APRA took a good look at its regulatory procedures in the aftermath and learnt the lesson from that episode that it was very important to take a proactive approach in the way you prudentially regulate institutions.

Q105 Lord Newby: As you have looked around the world from the relative security of Australia in this respect, have you drawn the same conclusion as you have watched what has been happening elsewhere, namely that although the structures vary from country to country—some have twin peaks, some do not—the way in which the regulators have chosen to interpret and exercise their mandate has had a greater influence than the actual structures in which they have been operating?

Dr Edey: Possibly we will talk a little more about this as we go on. I can see advantages and disadvantages to the twin peaks model. Both the twin peaks and unified central bank regulator models can be made to work. The most important thing is how the regulators go about their task in the way I described when I talked about how APRA did their job. I do not want to comment on the jobs done by specific regulators because I just do not know enough about exactly what has happened in every individual country, but I think that has been an important factor for Australia.

Q106 Lord Skidelsky: In Australia the micro-prudential regulator is separate from the central bank. Would there be any advantage in the micro-regulator coming under the central bank, as is proposed in the UK, and do you have any such regulatory change in mind?

Dr Edey: There is no proposal to do that in Australia at the moment. It is not really on the agenda because, given that our system came through the crisis in good shape, nobody is really advocating that we change the current regulatory model. You may be aware that we used to have bank supervision inside the Reserve Bank. The current structure was created in the late 1990s following the Wallis inquiry in Australia when bank supervision was taken out of the RBA and combined with the insurance regulator and the regulator of smaller deposit-takers to create APRA. Therefore, we had some experience of both models in Australia. The advantage usually claimed for bringing all of that inside the central bank is that it would ensure co-ordination among the central banking, monetary policy and the regulatory functions. You do need that sort of co-ordination. The disadvantage of doing it is that prudential supervision is a very big job. When we had bank supervision inside the central bank we found that for most of the time outside a period of crisis nothing was happening in the regulatory sphere, so central banks tend to focus most of their energies at the very senior level on the monetary policy function. I think there can be a case for separating out and specialising the institution that does regulation so it is more focused just on that task, but if you are to do that you need good co-ordination mechanisms between the two.

Q107 Lord Skidelsky: We have been concerned with the question of how you manage a potential conflict among micro-prudential and macro-prudential policies, financial stability and fiscal liability, financial stability and growth and monetary and macro-prudential policies. Do those conflicts arise? Have you experienced them? How do you deal with them?

Dr Edey: I do not think we have experienced any serious conflicts between those things. When we talk about macro and micro-prudential supervision, the boundary line between those is not always distinct. The way I think of it is that most of the instruments for prudential regulation are really micro-instruments to do with capital ratios and controls on what individual banks can and cannot do with their balance sheets. To my mind, macro-prudential policy really means using those instruments with the objective of stabilising the system as a whole rather than just the individual institutions. In a way, what we are talking about is using the same instruments but with a broader objective. It is system-wide rather than institution specific.

In Australia APRA is the micro-prudential supervisor and most of the time they are looking after the safety of individual institutions. The Reserve Bank has a macro-financial stability mandate. We are given the task of overseeing the stability of the system as a whole, but APRA has most of the instruments you need if you want to take regulatory action in relation to financial institutions. Therefore, you need co-ordination. We co-ordinate that through a group called the Council of Financial Regulators which consists of APRA, the Reserve Bank, the Australian Treasury and the Australian securities regulator. But we have never found any conflicting objectives or perspectives on policy within that. When you think about how micro-prudential supervision works, the safety of an individual bank is closely tied to the stability of the system as a whole. Those two things are very much interrelated rather than being in conflict.

Q108 Lord Skidelsky: To be clear, are you saying that the central bank has two mandates: one is presumably price stability, or an inflation target, and the second is to maintain financial stability?

Dr Edey: Yes, that is right. Under the Reserve Bank Act, which is our governing legislation, we have a very broad mandate which covers price, currency stability, full

employment and the general prosperity and welfare of the people of Australia. Potentially it covers anything that can come under any of those three headings. In more recent times, the Government have sought to clarify the mandate and make it more specific. Therefore, we have a specific price stability mandate that is agreed with the Government. We also have a financial stability mandate. That is the more modern redefinition of the mandate specified under the Act, but the Reserve Bank Act itself gives us a very broad mandate.

Q109 Mr Mudie: You answered one of my questions in your previous answer. Just on the point you have made, we have a target for inflation. Do you have different or additional targets on the stability front? You mentioned employment and welfare. Do you have specific targets in those fields, like unemployment and growth?

Dr Edey: We have only one numerical target and that is for inflation. Our target is 2% to 3% on average over the medium term. That corresponds to the Bank of England's target of 1% to 3% inflation. We have objectives to pursue full employment, financial stability and the general welfare of the people of Australia. Those things are not converted into numerical targets in the same way as the inflation target is.

Q110 Mr Mudie: When we had our crisis the big question was: who was in charge? On the macro-prudential side, what powers does the central bank have? Is it just a power of persuasion? The Council of Financial Regulators does not seem to have any statutory power. Is it just persuasion, or does it have any statutory powers over the regulator?

Dr Edey: The council has no statutory powers, so it is simply a body which co-ordinates the individual powers of the four agencies that comprise it. The powers of the Reserve Bank as you have said are those of persuasion. The Reserve Bank also has power to engage in transactions in the financial markets. Like a lot of central banks, we are active in foreign exchange and money markets, providing liquidity to the banking system. The second of those powers is very important in a crisis, because often you get self-fulfilling panics. People become reluctant to lend because of uncertainty. People become short of funds simply because of that self-fulfilling uncertainty, and in those circumstances central banks have an important role to play in providing liquidity to the system. Therefore, we play that role. Other than that, our role is, as you said, mainly persuasive. The Governor of the Reserve Bank is the chair of the Council of Financial Regulators, so we have a leadership role in that regard. We have done a lot of work with the other financial regulators, including APRA, to think through the procedures we need to follow in crises and stress situations to try to work out exactly how we will deal with them in co-operation with one another, but that relies very much on the individual powers of the institutions, not any overarching power of the council.

Q111 Lord McFall of Alcluith: During a crisis what is the channel to the politicians regarding the Council of Financial Regulators; in other words, when the money has to be given out how is that managed with the Reserve Bank and others?

Dr Edey: The Reserve Bank has only power to lend or buy and sell financial instruments in the market, so we do not see ourselves as being an institution which would bail out insolvent banks. In the recent crisis banks did not need any bail-out funds anyway, so the question did not arise, but the position of the Reserve Bank is that we do not hand out any funds.

Q112 Lord McFall of Alcluith: My question relates to the management process between the Reserve Bank and others and the Government itself. When the crisis struck in the UK we had a tripartite authority and the Chancellor of the Exchequer was an integral part of that. What is the equivalent of that in Australia?

Dr Edey: I do not know enough about how the tripartite authority works, but it sounds as though it would be playing a co-ordinating role similar to that played by the Council of Financial Regulators here. The council plays an important role in advising the Government. If we felt some action needed to be taken in an emergency we would be advising the Government that they needed to do that. If funds from the fiscal authority needed to be handed out for some reason that would be a decision for the Government, but the council would see itself as being available to provide advice on that.

Q113 Mr Laws: We have already had some discussion about macro-prudential regulation in Australia over the last few years. Can you run through the major tools that have been used since 2001 and indicate how effective you think they have been in securing the outcomes you described earlier?

Dr Edey: The main prudential tools that APRA has at its disposal are to do with the capital and liquidity standards for the banks. A lot of that is written into rules about certain ratios and standards that banks have to meet, but APRA also plays a role in going through the way banks provision for loan losses and calculate their exposures to various forms of risk. Therefore, they have a significant influence over the amount of risks that banks can take just by the way they go through those calculations with the banks. APRA also talk to the banks behind the scenes. If they see that banks are systematically taking too much risk in some area they will talk to a bank privately about that. That sort of conversation can have a lot of influence over the way a bank behaves.

Q114 Mr Laws: Are you considering bringing in any new tools in relation to macro-prudential regulation in Australia, or do you feel you have more or less what you need?

Dr Edey: I think the main one that would be under consideration is what is known as the counter-cyclical capital buffer. That is a tool which has been designed specifically by the Basel Committee for inclusion in the Basel III framework internationally. The way that buffer works is that a prudential supervisor would make an assessment as to whether or not credit expansion by the banking system was excessive, and various tests would be applied to determine whether that was the case. If it were the case, the prudential regulator would impose an additional capital surcharge on the banking system as a whole. That would build up capital buffers and have the effect of making it more difficult for banks to expand their lending, and it would also create a buffer that you could release in the event banks get into difficulties later on. That has been proposed internationally. APRA is considering it in Australia, but to have a good sense of how it would work is some way off because it has not been used in the past.

Q115 Mr Laws: Would it be fair for us to read your evidence as suggesting that people in Australia are pretty happy about the way the regulatory system works and responsibility is divided up or, in the same way that we are considering throwing things up in the air a bit in the UK, has the financial crisis prompted any re-evaluation in Australia about how the regulatory system is functioning, or should function in the future?

Dr Edey: People are pretty happy about the outcomes here. I do not want to sound complacent about that. It has been a mixture of good luck and good management. I know we do not want to be complacent about that. There is a global effort going on to tighten up regulatory standards further and we will be taking that on board in Australia. I think that either of the two regulatory models can be made to work. I can understand why, if you feel there has been a problem of co-ordination, you may want to change the system and try to get better co-ordination in a different way. In Australia I think the attitude is that the system has worked well in the latest period and so we do not see a need to change it.

Q116 Baroness Wheatcroft: I would like to ask you a little about those who are regulated rather than the regulators. There is a suggestion here that we should ring fence the retail side of banks. I would be fascinated to hear whether you think that is a good and workable idea or that the issue is more one of the governance and ownership of banks. Can you also say a little about how Australian banks are owned and governed?

Dr Edey: The issue of ring fencing really has not come up in Australia simply because Australian banks do not have very large investment banking activities. The big four Australian banks that comprise a large part of the banking market here really do most of their business in core deposit-taking and lending rather than investment banking activities. The idea of ring fencing really has not come up. Looking round internationally, there have been cases where banking systems have got into difficulties through international contagion, where you had very large banking systems in relation to the size of the domestic economy and very large international banking activities. There were a number of cases where that became a source of international contagion. That is really the issue which has given impetus to the question of whether you want to ring fence the core domestic operations of the banks in cases like that. It is well worth thinking about. I would not claim to be able to give you expert advice on it, but it is well worth thinking about ways you can limit the capacity for international contagion of that type. The sort of ring fencing proposal that the ICB is talking about is one way of addressing that. Another way of addressing it is by looking at subsidiarisation structures for international operations. Again, I cannot claim to give you expert advice on that, but I think it is well worth looking at.

Q117 Baroness Wheatcroft: One of the reasons the banks went from retail banking into investment banking was in a search for higher and higher returns on capital. Can you say a little bit, as I suggested, about the ownership and governance of Australia's banks and whether that might explain why they did not go in search of the same sort of returns, at least this time round?

Dr Edey: There are different views on that here. One view, which I think has some truth to it, is that during the period leading up to the crisis the Australian system was still adjusting to an earlier period of deregulation and an adjustment to low inflation and low interest rates. Therefore, there was a big domestic expansion of the Australian financial system already under way and plenty of growth opportunities, within what you might say is the traditional domestic market, allowed banks to be highly profitable, even without pursuing these other more international or newer market areas. I think that in the post-crisis environment it is important for banks to have realistic expectations about the sort of profit growth and balance sheet growth that is achievable, because one of the potential sources of risk is that if banks set themselves unrealistic expectations they expand into areas where they need to take on more risk, or risks that they do not understand. That can expose a financial system to problems further down the track. We have been actively trying to get that message out in Australia, and I think it is becoming well understood what the growth opportunities were. I think it is important for banks worldwide to have realistic expectations about how quickly they can grow their businesses.

Q118 Baroness Wheatcroft: To a certain extent my final question relates to what you have just been talking about. There are four major banks in Australia. The situation here is not so different. How do you ensure that there is a competitive environment for consumers?

Dr Edey: This issue has been the subject of quite a bit of discussion in Australia recently. One of the consequences of the crisis was that the big four banks gained some market share. One of the reasons for that was that the markets that fund banks and other

lenders in Australia became more cautious, so it became harder for some of the smaller institutions to fund growth of their balance sheets in the post-crisis environment.

There is a lot of debate in Australia about how competitive the system really is. In the pre-crisis environment it was pretty competitive on the lending side. Post-crisis, it has become more competitive on the deposits side. Because of the issue of funding that I just mentioned lenders have been competing harder in the deposit market to get the funds to enable them to continue expanding their lending. The Government have focused on the issue of competition in Australia. A package of measures was taken recently to try to address that. It included things like account switching procedures to make it easier for people to switch banks and promote competition in that way. It is something on which we have been focused, but I do not know whether there is any magic solution to it.

Chairman: Dr Edey, thank you very much indeed for your evidence. It has been extremely clear and helpful and it has got us off to a very good start to our day's proceedings. We are very grateful to you for staying on late and getting us up early and off to such a good start.

Dr Edey: Thank you very much. It's been a pleasure.

Examination of Witnesses

Witnesses: **Christine Farnish,** Chair, Consumer Focus, **Peter Vicary-Smith,** Chief Executive, Which?, **Gillian Guy**, Chief Executive, Citizens Advice, **Martin Lewis,** moneysavingexpert.com, and **Paul Lewis,** freelance financial journalist, examined.

Q119 Chairman: Thank you very much indeed for coming to us today and the evidence you have already submitted. We are very grateful to have a very distinguished panel of witnesses. It is going to be slightly difficult because, obviously, we do not want five replies to every question. On the other hand, we want to draw on all your experience and expertise. Perhaps I may start the ball rolling by putting a general question—but please do not feel that all of you are obliged to answer it—about the application of regulation to ensure we do not have future crises without, in the process of preventing them, restricting consumers' access to financial products. Would anybody like to give us some observations on that?

Christine Farnish: I would be very happy to kick off, if I may. Obviously, it is very important we strengthen and seek to improve the UK's regulatory regime in the wake of the recent crisis. The danger will be that we lurch too far in one direction in pursuit of a single objective. As we all know, the world is a lot more complicated than that. We have quite serious concerns about the fact that very significant powers are being given to the new Bank of England group. The FPC will be able to direct the new regulatory bodies, both the PRA and the FCA. The PRA will have a veto over the FCA. We do not think the balance is right yet in this draft bill; it is too one-sided. If you go too far in terms of financial stability obviously you will not deliver what is required for both the UK consumers and businesses in this country. It is a balancing act, and we think the strategic objectives are not yet sufficiently balanced.

Q120 Chairman: Is that a general view?

Martin Lewis: When I went through it I had to read it again and again until I started to understand how the system began to work. Even once I started to understand what the FPC, PRA and FCA did—frankly, there are more acronyms than the driving licence authority—I realised that it did not include competition and credit, which are what people think finance is

about—making sure it is competitive and there is credit out there. As an overarching starting point, even trying to work out what everybody does is incredibly difficult for an experienced personal finance journalist. How the hell the public will ever grasp and have confidence in this form of regulation I do not know, because it is way too complicated. The names are far too complicated. We are using acronyms already which just do not help anybody. The names are not descriptive. When you look at where consumers are in this—it is the third body that cannot look at competition and does not really deal with credit, which is what I tend to have most problems with because I am a consumer, because debt is really what it is all about. Then you may have some consumer representation on the consumer panel, but the other two big and important bodies do not. Therefore, when a decision is made that we need to curtail the amount of lending done by the FPC because it is impacting the economy, and suddenly realise that effectively you trap people in their existing high-rate mortgages so they cannot remortgage and leave them stuck at that level, we have a real problem about the limited extent to which consumers are being thought about in the system. More importantly, we cannot have faith in a system we do not understand.

Paul Lewis: The FCA, as Martin Lewis has said, is the only one that has any obligation towards consumers, and it has to provide the appropriate degree of consumer protection. We really need an agency that provides consumer protection, full stop. The kind of dilemma it will have, which is exactly the one I pointed out to the FSA over many years, is that if the FCA knows a bank, building society or financial body is in trouble, to protect consumers it should tell everyone. To preserve the market it should keep its secret. Dealing with that conflict is, I am sure, going to come down on the side against consumers and they will be left in the dark. The degree of interplay between them is not clear, and consumers should be much more at the heart of at least the FCA because they are nowhere else.

Q121 Baroness Wheatcroft: You can look after the interests of consumers only if you are doing so within a stable financial environment. Would it not be fair to say that part of what went wrong with our previous regulatory system was that the FSA, albeit it did not do it terribly well, focused far too much on the consumer side of things while nobody was actually looking after the overall financial environment?

Paul Lewis: I would not say it did look after consumers very well. It has changed recently but that has been since the crisis in 2007-08. Before that, it did not do enough for consumers.

Martin Lewis: I am absolutely flabbergasted. You must live in a totally different world from me. The FSA has done bugger all for consumers over a long period of time and left them completely in the dark. I first wrote about PPI in 2001. There was a super complaint in 2005. There was an 80% uphold rate by the ombudsman and £6 billion being paid out. We nagged the FSA and it did nothing. It did nothing over bank charges. I do not know what world you live in, but I certainly do not think the FSA did very much for consumers. People do not think the FSA did very much for them. When I asked people what they wanted me to say here, everybody said, "What does the FSA do? It's done nothing to help us." You must have a different period of reflection. I agree that overarching stability of the system must be fundamentally important, but hopefully that crisis comes once in a generation and we need to have the right structure. The day-to-day problems of real people are about their interaction with financial services that are far too powerful and tend to operate in ways that they do not understand. We are a financially illiterate nation being held at the mercy of banks and big financial institutions. I think the regulator has had the power but not the will or institutional idea behind it to look after consumers, so we come from a very different perspective.

Q122 Baroness Wheatcroft: Mr Lewis, I said they may not have done it effectively. Nevertheless, with initiatives like treating customers fairly I contend that the focus of the FSA was far too much on the consumer side of things and nobody was looking at the macro side. Christine Farnish is probably in a better position than I to address this point.

Paul Lewis: I absolutely disagree with that, as Martin Lewis has said.

Gillian Guy: Perhaps I may put a different perspective. In Citizens Advice we are dealing with over 2 million consumers every year. We are talking to them about the issues they confront and do not expect legislation necessarily to be crystal clear to everybody at First Reading. It is a job we all need to engage in to make it clear to people what the Bill will do and try to simplify and strengthen the regime. As Christine Farnish has said, it must be a question of balance between prudential regulation and conduct. From our perspective, it is very important that it is not just about how the organisations are set up but their culture and whether they are likely to be champions for consumers through the FCA. For us, all consumers are not just a homogenous mass; some are much more vulnerable. There are issues of equality where people need particular consideration, and that impact needs to be considered in the prudential area. We also need to think about strengthening the "have regards" in the FCA and be proactive in preventing consumer detriment and minimising that for vulnerable consumers. We will probably want to say something about strengthening the objectives to make sure there are outcomes attached for consumers so we can then explain what difference this will make, as opposed to exactly what it will do.

As to the culture itself, we would like a super complaint attached to the FCA so we can see, as we did at Citizens Advice through PPI, that action will be taken and it will not just be words on paper, which is important in explaining the position to the consumer. We would also ask for credit control probably to go in that direction and to have a rules-based system so we can ensure it is not just enforcement after the event but rather heavier regulation of what goes on in the credit arena. At the moment too many people slip under the bar, get through the threshold and become registered. There are many rogue companies out there and a lot of consumers are suffering, and it is always the vulnerable ones who suffer most.

We can see some benefit in strengthening the current system. In that regard we would also want to keep the CCA—the Consumer Credit Act, for those who do not like acronyms—but strengthen and build on it in order to have a rules-based system through the FCA.

Peter Vicary-Smith: This cannot be an either or. We cannot say either we want to do good prudential regulation or good consumer regulation. The truth is that we need both done well. The FSA did not do either well. We should not be getting into trade-offs. We need bodies that can handle both sides, because if the prudential regulation fails the market is messed up for everybody. If the consumer regulation fails, then consumers will not have trust and purchase. Both have to be done well.

Martin Lewis: To go back to my initial point about the complexity of the system, if it is so complex you do not understand how you are being protected you do not have confidence in it. If consumers do not have confidence that is a prudential macro issue, because they do not want to deal with banks. People—thankfully, not many—talk about putting money back under the mattress again. None of us wants that. Your home insurance is not anywhere near as good as the FSCS. What we want is to make sure there is confidence in this complex system. If I may echo what Gillian said, and this has been the position for years, the fact that a bank account is regulated by the FSA when in credit but probably by the OFT when it is overdrawn because it is consumer credit is just nonsense. People do not understand why financial regulation should include debt and credit. There should be one body. A bank is one body and it needs to be regulated in one place, and competition and credit need to be part of this. To have a regulator that cannot look at competition means you have neutered it from the start.

Q123 Baroness Wheatcroft: Are you uncomfortable with it all being taken under the wing of the Bank of England and with the governance of the Bank of England itself?

Martin Lewis: To be absolutely honest with you, that is above and beyond my pay grade looking at a macro level. I want a body that works and has a culture that looks after and helps consumers. We have not had that. If the august ladies and gentlemen in this room will forgive me, you can come up with whatever system of regulation you like, but unless you change the culture of the organisation to protect individuals it is not worth the paper it is written on. They have had many of the powers we have wanted for a long time but they have not been used. If I were doing this I would have people in a room of that organisation whose brief was to read social message boards, listen to what consumers were saying, read the newspapers and say, "Well, that's an interesting issue. Should we be looking at that to make sure it's happening?" so they are ahead of it, instead of waiting for people. We had over one million template letters on payment protection insurance downloaded before the FSA started looking at this. That is just not good enough.

Christine Farnish: Perhaps I may comment on the question raised by Baroness Wheatcroft about the Bank of England, which is a very important issue. The Bank of England group going forward will have an unprecedented suite of powers. It will be responsible for monetary policy, financial stability, what is known in the jargon as macro-prudential regulation and micro-prudential regulation, which we have just been talking about. It will have the function of lender of last resort and the provision of liquidity to the financial system; and it will be overseer and regulator of the payments systems. In addition, it will be a special resolution authority if a major institution goes belly up. That is an enormous suite of very wide and significant powers which potentially will have a huge impact on everyone's daily lives, the availability of credit, the way in which the financial system is working and the economic welfare of this country. To us it is very surprising that that suite of powers is being granted to a body that has no formal accountability to Parliament or the general public. There is a lot of work to do in the way in which the accountability and governance arrangements in this Bill are formulated to strengthen those arrangements.

Peter Vicary-Smith: One very good illustration of the lack of awareness on the prudential side about the consumer impact of this set-up is the PRA objective with regard to insurance. It is argued that it should have to contribute to securing a degree of protection for consumers, yet this is the sole body responsible for regulation of with profits funds of £330 billion, with 25 million individual holders, and yet the regulator has only to contribute to securing a degree of protection. That has to change, because that's where the buck stops if there are continuing problems related to with profit funds, which we have all been arguing about for years. At the moment the consumer dimension seems to be an afterthought in the PRA.

Paul Lewis: Perhaps I may give an example of where the law needs changing. You are talking about a Bill, but the existing law is very damaging in this way. It is about the FSA and what it can reveal. In 2006 it did a mystery shopping exercise about pension churning, basically taking one person out of one pension and putting him into another. In that it found that a third of the firms looked at were mis-selling pensions. It was only two years later in 2008 that it took any action against some of them. When it first did so I said to the FSA, "Tell us who the third are; or, if you don't want to do that, at least tell us who are the two thirds doing it well." It would not do so. On that and other occasions in this kind of secrecy I have been to the Information Commissioner. One case even went to court eventually. There is a section in the Act—I am sorry I cannot quote it this morning—that stops the FSA revealing information during the course of its activities.

Peter Vicary-Smith: Section 348.

Paul Lewis: Thank you. If that persists in the new Act the FSA, whatever it might want to do and however you might change its objectives, will not be able to tell us. I would say to people from the FSA who are on my programme, "Look, you know the firms that were mis-selling; I don't, and as we speak people are going to them for advice and being mis-sold." They said, "We can't tell you; it's against the law." I have to say they are quite right about that, so that is a bit that needs changing.

Q124 Chairman: That is a very important point. I am told it persists in the Bill, so we are grateful for that point being made.

Martin Lewis: There are very few bad products. In all the years I have been doing this I have seen very few products that are not suitable for somebody. The problem is that we tend to look at a product and say that it is treating customers fairly because they have all the correct forms. That does not mean they are treating them fairly; it just means they have dotted all the i's and crossed all the t's of the documentation they need to provide. That was my greatest problem with treating customers fairly. It is not about fairness but about whether you have passed the bureaucracy test. It does not help financial companies and has not helped consumers.

There are very few bad products, so what has been going wrong? Why do we have so many mis-selling cases, so many consumers who are disenchanted and no longer trust the institutions? It is because the products are sold badly, or not sold at all, and the marketing information that goes with them is poor. Of course, products are not a one-stop shop. We tend to forget that when somebody has signed up for one, whether it is a pension, annuity or insurance product, they are ongoing products, so the ongoing treatment of the customer is important. We have to stop looking at the product and look at it in the holistic way an individual deals with it if we are to be able to regulate it properly. Paul was exactly right. The mis-selling of a product is often seen to be considered secondary to the product itself. In my experience, cash back credit cards—let's take them as an example—are wonderful if you pay off in full every month. If you do not, they are a horrible experience. It is not about the product but how you interact with it. That is the bit which tends to get ignored, and we need to make them look at that.

Gillian Guy: We are saying that all of these matters are a question of balance. I agree with Peter that both sides of this need to be dealt with but each needs to look at the other and consider what impact it is having over the fence. I slightly disagree in that some of the products are bad in terms of the business plan to roll them out and the way in which it is planned to administer them, not necessarily the conduct; for example, payments up front but that don't deliver the goods later on. That does not deal with the culture, but that business plans are looked at is an important tool.

We also seem to concentrate very much on the powers given to these organisations. Perhaps we can look more at duties and responsibilities for those organisations that ought to go alongside the powers. As far as concerns the PRA, it ought to have a duty to pay regard to the impact on all consumers, which is my earlier point about financial inclusion and exclusion, and also minimise hardship. A prudential measure can, by its implementation, mean hardship for people if it is taken out of time and people's circumstances are changed without an understanding of their glide path to that change and it being managed appropriately.

As far as concerns the FCA, there ought to be a duty to investigate where there is evidence of mis-dealings, mis-selling or any of those things that give rise to consumer detriment. That is why we think the super complaint on top of that will make sure the culture shift is one about consumer protection.

Q125 Chairman: This has been a very interesting start to our discussion, not least because collectively I think you are making a point which echoes what we have been hearing in discussing macro-prudential regulation: it is not simply a question of structure but culture. That culture is partly determined by your powers, the objectives you are set and the accountability within which you operate. Perhaps we can focus on those three things. Simply on the powers, the Government are considering the transfer of the consumer credit regulation to the FCA. Do you think that is appropriate; if not, how should it be changed?

Paul Lewis: As Martin said, it is daft to have two different regulators for what is in effect one set of financial products. If you have a bank account it is regulated by the FCA; if you become overdrawn it is regulated by the Consumer Credit Regulations, so it is absolutely daft. The simple answer is yes, and I cannot imagine why anybody would think anything else. A slightly more detailed question is whether it should transfer as the Consumer Credit Act or it should be completely rewritten under FSA's complex rules; that is, ICOBs, or the Insurance Conduct of Business Rules, whatever it is called. I do not have an answer to that. One set of rules is probably better. That is the debate we should be having, not whether it moves to the FCA, because I think the answer, plainly, is that it should.

Q126 Baroness Drake: I want to develop your point that culture is influenced by objectives. I would be particularly interested to hear a response from Which? and Consumer Focus. We know that the proposed FCA's strategic objectives are to protect and enhance confidence in the UK financial system. I would be interested in hearing your view on whether the FCA should have that as a strategic objective. From your point of view, is it the right objective from the perspective of consumer protection and fairness outcomes?

Peter Vicary-Smith: It is absolutely the wrong objective. If there is one message I want to leave in all the evidence we are giving it is that this is the most important thing to sort out. I would argue that the current strategic objective sends a message that regulators should be more concerned about the perception of confidence than the reality of protection. To my mind, trust and confidence are an outcome of a fair and transparent market. If you make it an input you put upon the regulator the burden of not revealing things, so the best way to have trust and confidence in the financial services industry is never to tell anybody when there is a problem. That kind of tension is quite entwined within the FSA, and we have seen that over the years how to manage trust and confidence while protecting consumers has given it real problems. It has led to a refusal to give information, laggardly behaviour and it wanting to do everything behind closed doors and in agreement. We argue strongly that the primary and strategic objective should be to maintain a fair and transparent market for financial services. If you want to put the word "confidence" in there then it can be "a fair and transparent market which leads to justified confidence in it", but trust and confidence must be an outcome, not an input. Otherwise, the regulator will be bedevilled by what it does in any particular real situation.

Christine Farnish: I have worked for the FSA and I know how important the objectives are in terms of driving culture. If we do not get right the formal statutory objectives of these new bodies in the legislation this time they will drive pretty well everything. Everything comes back to them, so they are extremely powerful and critically important. I agree with Peter. I worry about confidence being the overriding single objective. I can see the attraction of having a single objective. Obviously, that gives a much clearer focus. However, I am not sure it is quite as simple as that. If you just have confidence there the regulator could be held back from intervening early in an emerging problem, which may or may not blow up into something quite serious for consumers and another mis-selling crisis, because they do not want to disturb confidence. We should remind ourselves that consumers were totally confident in institutions like Northern Rock until the day before they looked at their television

screens. I am not sure that confidence is the right overriding objective. It is very important that consumer interest is at the heart of this new regime in the FCA and that it has a proper statutory objective on competition as recommended by Sir John Vickers earlier this week. My understanding of the formulation in the Bill is that it does not have the status required to allow the FCA to draft rules to promote competition, and that is a very serious weakness.

Gillian Guy: Perhaps I may build on what Peter said about the objective of confidence. I agree that confidence ought to be a bi-product of having got it right in the first place. To get it right in the first place, if the objective is about making the market work for all consumers, but also to have a credible system of deterrence and redress, that begins to build a package and an objective with outcomes for consumers that will probably start building confidence.

I also want to pick up Christine's point about competition. Our concern is that competition is seen as the magic bullet that sorts out all of this, remembering that competition works for some consumers and against others. Sometimes they are left out of that competitive market. For example, when we have free-in-credit offers those who are not in credit suffer and subsidise those offers. We have to make sure that when we are looking at competition we consider the impact it will have on all consumers. If we had an objective that was clearly about working well for all consumers and having deterrence and redress, we would scotch some of that at the same time.

Peter Vicary-Smith: The ICB puts that competition point very well in its paragraph 6.5: "The underlying problem in such cases is not competition but the frameworks, including consumer protection and financial regulation in which competition takes place. To blame competition would be to misdiagnose the problem." To paraphrase it, in short a distinction is needed between good competition to serve customers well and bad competition that exploits consumer awareness or creates a race to the bottom. Therefore, it is not as simple as competition; you need to define competition more particularly. It is not a silver bullet.

Paul Lewis: I think openness assists confidence. The FSA has a namesake in the Foods Standards Agency. Let me refer to its bulletin I printed off last night: Stella Artois Cidre has been withdrawn; Asda has recalled six Chosen By You drinks due to possible choking hazard; Waitrose has recalled own-branded meat products due to listeria contamination; and Kettle Foods has withdrawn kettle chips. Those have just happened. Do we have any less confidence in Waitrose, Asda or Kettle Foods because we know they have withdrawn food that is dangerous? No. It increases our confidence, and yet if you talk to the FSA at present they will not tell you what products they have discussed or have had withdrawn. They should be publishing every day a list of things they have found wrong and who has withdrawn them. Then I would say, "Prudential is a good insurance company. Look; it's taken its product off the market because it doesn't do any good."

Q127 Baroness Drake: To put a follow-through question, I am picking up a tension between confidence and consumer interest and transparency and the way that is operated. You have both articulated the problems on both the demand and supply sides. In essence, what would be the kind of effective competition that in your view would reduce the need for monitoring firms' behaviour and produce the better consumer outcomes that you would like to see?

Peter Vicary-Smith: It is not about competition reducing the need for interventions. Consumers have a variety of needs and financial service companies should be genuinely innovating, not changing the headline rate or name, to meet those needs. They should be doing that in different ways, each of which is trying to address the consumer need better than another. The consequence is that if alongside it there is clear communication to consumers about the benefits of each offer, and a regulator who makes sure toxic products do not get to

the market in the first place, you have a more transparent market in which consumers will start to have more confidence. I think competition is one of the vehicles. We think that dimension is handled well within the objectives. It is one of the second-tier objectives alongside consumer protection, and they sit alongside each other. We think that is a good place for them to be. It is just that the strategic objective is wrong.

Q128 Lord Maples: I want to move into the area of competition from a slightly different direction. We all know the virtues of competition in promoting efficiency, choice, innovation, reducing costs and price tension, but if you protect consumers too much they lose what responsibility they have. Obviously, there is a balance to be struck. Since we are spending a lot of time looking at banking regulation here, one of the areas where this seems to have happened is in banks taking deposits. You mentioned Northern Rock. I was staggered by the number of people who had put their money in Northern Rock for an extra 0.25% or 0.5% compared with what they could have got in HSBC, Barclays or whatever without apparently any consciousness of the risk. Since that happened we have altered the deposit protection scheme to give 100% guarantee up to £85,000. If you are a consumer you are taking absolutely no risk at all. You know you have a Treasury guarantee up to £85,000 in any bank.

Martin Lewis: That is not correct. You do not have a guarantee up to £85,000 in any bank. You have a guarantee of up to £85,000 in any financial institution. RBS and NatWest are one conglomerate—

Q129 Lord Maples: I recognise that.

Martin Lewis: But you made the point that consumers should be aware of this. My point is that RBS and NatWest are one conglomerate and have separate institutional protection. Halifax and Bank of Scotland are another conglomerate. They have a joined institution. Try to look this up on the FSCS or FSA website.

Q130 Lord Maples: I had some difficulty finding it myself.

Martin Lewis: There is a lot more complexity, so where do you trust? We do not understand that.

Q131 Lord Maples: I am trying to make a slightly different point. I do not know what percentage of deposits are under £85,000, but I would guess the vast majority of the kind of consumers whom we feel need protection are probably under that. Do we not now have a position where the consumer has no responsibility at all in making this deposit? Therefore, we are encouraging them to choose the more risky institution. Does this present a prudential hazard for the whole banking system? Within 48 hours of the collapse of Northern Rock the Chancellor of the Exchequer had effectively guaranteed all the liabilities of the British banking system because one relatively small regional mortgage bank had got into difficulties. As it turned out, it was both insolvent and illiquid, but we did not know it was insolvent at the time. Where do you see that balance? Do you think that particularly in competition for deposits we have created a risk-free environment for consumers, which therefore creates a very risky environment for the taxpayer?

Paul Lewis: I really do not agree, Lord Maples. Yes, you won't lose £85,000, but if you try to work out the best place for your money it is immensely complicated. There are terms and conditions about when you can take it out and how long the interest rate lasts for. It will disappear in a year in many cases. Do you have to give three months' notice? If you take money out of Nationwide, for example, I think you lose all or almost all the interest in that month. It is immensely complicated. You have choices to make. The example I often give is that if I buy a motorcar I am not allowed the choice of having window glass in the

windscreen, which will save a few pounds, or reinforced glass. I must have reinforced glass because I am allowed to be sold only a safe motorcar. I can choose all the interesting stuff. I think that is exactly where we are with deposits now. You choose the interesting stuff but safety is a given, and so it should be.

Martin Lewis: I agree. We want people to save. I would agree with your thesis had the teaching of financial education in schools been compulsory, as it should be, from the age of five so people had the tools in their mental arsenal to understand and make these decisions. You need to accept in this room that most of the public are financially illiterate and scared. People do not look at their bills because they do not understand them. It is about financial education from an early age. It must be compulsory. Every time I sit here and talk about these types of issues I say that if you want the cheapest way to fix it make sure people understand how the system works. Your argument does not hold water until the majority of the public are not financially illiterate. Until that point, the most important thing we have done with deposits is to make sure people understand that if they save in them they are safe. ING DIRECT is an account very widely advertised on the television. It does not have to tell the public that if, in the very unlikely event—thankfully, it is a big, safe bank—it went bust they would not be protected by the UK Government that they vote for, because they would be reliant on the Dutch Government to protect them under the passport system. There are still many problems, and it is worth addressing those more than talking about the moral hazard of protecting all savings. We want people to save for their future and to have trust in the system. It is good that we have now put up the limit to £85,000. I just wish we could solve the remaining complexities.

Peter Vicary-Smith: Consumer responsibilities are already well established under common law, so the principles of reasonableness, good faith and disclosure and action are already there as responsibilities that lie upon consumers. The problem that we fear this Bill creates is that if you go into Tesco to buy a ready meal you look at the price and consider whether you will like the taste of it. You do not have to worry about whether it will poison you; that is Tesco's job. But the way the Bill is currently drafted places far too much responsibility on the consumer to work out whether or not something is safe. That is a real problem and will reduce confidence and trust, because people will work that out and won't buy.

Paul Lewis: It is nothing that the Bank of England could not do, incidentally.

Peter Vicary-Smith: One body we consulted upon this Bill said, "It's as if the Bill's draftsmen were at pains to ensure that consumers should only have themselves to blame. There is an utter imbalance at the moment within the Bill between the responsibilities lying on consumers and the responsibilities lying on financial institutions." I know you are not saying this, but I think it's a bit rich for bankers to complain about risk-free deposits by consumers at their banks considering that the entire cataclysmically risky lending of banks was all underwritten by the consumers as well, so they had a pretty good taxpayer guarantee too.

Christine Farnish: Perhaps I may comment on a point of consumer responsibility. We see in two places in this draft Bill the general principle that consumers should take responsibility for their decisions, which is copied from the Financial Services and Markets Act. We have great difficulty with the inclusion of that clause as part of the consumer protection objective. The problem is bigger because this is very strange legislation in consumer terms because it defines the consumer as anyone from my mum to a hedge fund manager. No other legislation which talks about consumer interests and protection in other parts of regulated markets would have such an astonishingly broad definition of "consumer". It makes it very difficult for the regulator to focus on where protection is really needed because of that broad definition. Of course you need consumers and hedge fund managers to

take responsibility for their dealings. There is a difference here between sophisticated market participants, who have knowledge and should take responsibility, and consumers who do not do this by way of business and are, generally speaking, vulnerable. I would define myself as a vulnerable financial services consumer, yet I have spent the last 15 years working in financial services, if I am buying many complex products. There is a real issue here.

Gillian Guy: That is a really important point about all consumers. That does not mean all consumers are the same. It means looking at a differentiation of what the consumer market is like. My feeling about its inclusion in the Bill is that it ought to be about putting consumers in a position where they could take responsibility. They cannot do that at the moment because the environment is not safe for them to do so.

Q132 Chairman: Is it because the environment is not safe or they do not have the transparent information?

Gillian Guy: They do not have the information and knowledge and necessarily the confidence that other people are looking after that safety for them. I would echo the point about education and putting people in a position where they are capable of taking decisions. At the moment the Government are considering whether to continue funding to make sure people get that kind of education. That is really important in the whole atmosphere of allowing people to take responsibility.

Martin Lewis: As a very important point of information, we have become a culture where we demand that financial services institutions provide all the appropriate information about their product, although there are still areas lacking, such as they cannot quite tell you what interest you are earning on your savings account, even though they can tell you the specific interest you have earned. I have never quite understood why that is so difficult for them, but they have my sympathy.

The real problem here is that we have said we will provide information. Take a credit card summary box which tells me there is a 56-day interest-free period on my credit card. How many people know that does not mean it is interest free but that you must pay off in full by the end of the month or you will be charged interest? It explains the repayment hierarchy on my credit card. How many people understand that? We have become a tick-box information-based system whereby to treat customers fairly you must give them all the information. You do not have to make sure that information is understandable or explained. We cannot underestimate our financially illiterate society. Most people are given the information and ignore it because they do not understand it and there is no way for it to be explained. We are trying to assign too much responsibility in a market that is often driven and run by confusion marketing. The system is designed to confuse to stop churn and so people look at the headlines and do not understand the real problems. The information is out there so that the companies can justify their actions, but there is no explanation or understanding by everyday consumers. In some ways, it is very good. I have made a living out of providing that information to people, so it helps me but I would far prefer that you put me out of a job and gave better information and explanation in the first place, to be honest with you.

Chairman: We will do our best.

Q133 Mr Laws: I think we are getting the message that there is probably a consensus among the five witnesses that to assume consumers are responsible for their decisions puts too much weight on them, but that brings us to the very difficult issue of how you regulate in a world where the reality is one of financial illiteracy, or lack of knowledge. Reflecting on products like shared appreciation mortgages, or perhaps the mortgages now being advertised that appear to have very attractive rates but are linked in future to base rates plus 4% or 5% so

it can get people into potentially quite big problems, how the hell do we regulate that? I would be quite confident that Christine is not quite as inexperienced and naïve as she says; I think she can manage her way. I think Lord Skidelsky would be fine in deciding whether he wants to buy those products, but I am not sure all of my constituents would be. That creates a very tough situation where regulators have to consider consumer protection that differs for different consumers. Starting with Paul—the other witnesses can say whether they disagree with him in any way—how do you regulate for that type of risk?

Paul Lewis: Consumers have to take responsibility but they should do so only among products that are broadly safe. They must make the decisions which suit them, but they must not be encouraged to invest in or save in something that is inherently dangerous, only if that is explained to them in huge red capital letters. Over the weekend I had an argument with the independent financial advice community about what is called trail commission: the annual charge on a pension or investment. I was saying it was a secret; they said it was not and it was in every document they gave to people. In the one that I saw it was on page 16 and was expressed as 0.5%. You do not really understand it. More than half the people with pensions did not know it was paid. If you look at the broader population, the percentage is higher than that. Although you can give information it is where and how you give it.

Q134 Mr Laws: We might agree on things like that, but when we look at products like shared appreciation mortgages, or mortgages linked in future to base rates plus *x*, *y* or *z*, those are not simple in a world of financial illiteracy but are not completely beyond consumers taking some responsibility either. With those particular products in mind, do they fall into your dangerous category?

Paul Lewis: Yes. There are things I would have banned at the start, endowment mortgages for one.

Q135 Mr Laws: What about my two specific examples?

Paul Lewis: Shared appreciation mortgages. Yes. They are too dangerous. Your house is too important to let it rely on stock market performance.

Q136 Mr Laws: You would not even allow Lord Skidelsky or Christine to buy a shared appreciation mortgage; you would ban it from the market?

Paul Lewis: I would, and I would do so simply because some things are risks that people should not be allowed to take.

Q137 Mr Laws: That is quite draconian. Are the other witnesses in that category?

Paul Lewis: You should have regulations so that some products are not allowed. I am sure many of my colleagues will not agree, but I take a hard line on that.

Martin Lewis: I would go the other way. Shared appreciation mortgages were a clever product with a very high risk for people who understood that effectively they had a cheaper deal based on house price appreciation. There are a couple of things. We have a mortgage ticking time bomb because people think they have cheap mortgages and, once interest rates come back up, they will be phenomenally expensive. We will cause ourselves all heaps of hell because of that. Someone should be acting on that now, never mind sitting in this room looking at long-scale regulation.

When we start to talk about regulating price, which in many ways is what we do, we are delving into a territory where we have never been before. I do not believe this is as difficult as you think it is, because it is the type of thing that Paul and I do every day. When new products come out myself and my team go through them and write a list. We write a big article that explains, “This is where it may work well; this is where it may work badly; this is

what you do right and this is what you do wrong." These days I have 38 staff and about 15 of us work on editorials looking at this. That is not a very big team. I suspect the FCA may be slightly better budgeted than my internal staff. What has been relied on is super complaint, which is fantastic. The FCA should absolutely be allowed to take super complaints; it is ridiculous that it won't. Just by looking at what is being said in the marketplace and reading the newspapers, you tend to see the dangers here. I do not believe it is beyond the wit and wisdom of a regulator to be monitoring what is coming out and have sophisticated individuals on product teams who are experts. It does not take many people to cast an eye over what is coming, spot the dangers and then make sure the dangers are being communicated correctly.

Q138 Mr Laws: I am sorry to come back to the same example but it crystallises things very clearly. You say that you would not be as draconian on shared appreciation mortgages. It is obviously still an issue for many consumers. Paul is willing to be quite draconian and say they are far too risky. You would acknowledge there are some people who understood the gamble they took in what looked like a cheap mortgage?

Martin Lewis: I am trying to remember shared application mortgages. They were there before I started but, if they are what I think they are, one of the biggest problems is that the examples given in the material did not include the fact that we might have a house price boom. People got caught by how much they would have to give back.

Q139 Mr Laws: The banks would say they did not include a house price bust either.

Martin Lewis: They should have included both. There should have been big warnings in font 140 saying what would happen if there were a house price boom or house price crash. It is not that difficult to do these types of things. Baroness Wheatcroft, when you write articles, you investigate something and gives the pros and cons. If banks spin their products to best advantage a regulator needs to make sure people understand the real level of risk they are taking. It is not that difficult.

Q140 Mr Laws: Are you saying that ultimately you are satisfied with consumers taking responsibility, even for some quite risky products, provided the warnings are "clangingly" obvious?

Martin Lewis: And there is an explanation, questions are answered and it is done properly. It should be done on the basis of what we would say if you or I were selling it to someone to discuss with them whether it was good or bad.

Paul Lewis: The point is that if you did do that with shared appreciation mortgages nobody would have taken one out. It has to be upfront with big warnings.

Peter Vicary-Smith: I have a relatively simple approach to this. There is a company called TP Activity Toys which makes climbing frames. It has a rule that a climbing frame cannot go out until the marketing department can assemble it, on the grounds that if the marketing department can do it any customer can do it. It is a bit like that with some of these products. So often we find that a product is developed and the banks or financial institutions themselves say, "Not all of our sales force will sell it because they will probably not sell it properly." If that is the case, you should be selling it only with advice so the consumer has that interpretation and there is a duty placed upon the advisers. By and large, I am relaxed about the products existing, but they should be sold with advice so the adviser has a responsibility. It should not be sold just through the normal branch sales network.

Christine Farnish: The interesting thing about the whole debate about product regulation is that in many respects it is in both the wider consumer interest and the interest of the industry to try and get a better settlement than we have had over the last 10 or 15 years where the focus has been very much on disclosure, more information, and abiding by the FSA

rule book. You tick all the boxes, but as long as you do all those things pretty well anything goes. If something blows up you go off to the ombudsman. That is a very expensive, inefficient system that really imposes a lot of cost which consumers ultimately bear, and does not even deliver the right outcomes. I think there is a genuine common interest to get a better way through. In this legislation we need enough enabling power for the regulator to facilitate and encourage that process.

Q141 Chairman: As I understand it, there are new powers in the Bill on product intervention, financial promotion and early publication of disciplinary actions. Are those powers sufficient or do they need to go further; and, if so, how?

Christine Farnish: They are certainly an improvement on what we have at the moment, but the will to act is the critical thing. That is where regulatory culture will be so important.

Q142 Chairman: We take that point on board.

Martin Lewis: Perhaps I may raise one of my pet points that I wanted to say when we came in. I refer to the ridiculous disjunction between the ombudsman and the regulator. Year after year we see systemic mis-selling where the ombudsman is awarding in over 50% of cases in an industry and nothing is done about it year after year. There has to be some join-up in this Bill between the complaints consumers are making, which are being upheld by the independent arbiter, the ombudsman, and the regulator acting on them. If an industry has a complaint rate of over 50% it should be an automatic super complaint which must be responded to within six months by the regulator. PPI is a wonderful example. A secondary point you must understand—I know you are to talk to the ombudsman later, who I am sure will echo this—is that companies deliberately reject cases they know the ombudsman will uphold because it puts off consumers. Only 10% of consumers then go on to the ombudsman. We have had uphold rates in PPI—it has changed since the ruling—of 90% to 99%. Exactly the same case is made by one consumer, is rejected by the bank and it goes to the ombudsman. The ombudsman upholds it. Another person comes along with the same thing and they reject it. Rejection of complaint has been used as a tactic to pay out less. If I were writing a Bill the one thing I would put into it is that there should be a fine if you use rejection as a tactic. It clogs up the system and the ombudsman.

Chairman: I am sorry to cut you off. It is an important point; we have got it, but we have very little time and do not want to cut out other important points.

Q143 Lord McFall of Alcluith: I am interested in financial inclusion. We have made quite a bit of progress in the past few years. What do you see in this Bill which will foster more financial inclusion?

Christine Farnish: Very little. Possibly there is something missing from the consumer protection objective or the "have regard to" list for the Financial Conduct Authority. It would be quite easy to look across at other regulatory regimes, whether it is energy, communications or any of the other major services that are so important to daily lives, and see their formulation and what would be appropriate in this Bill. To us, it is very important that the new Financial Conduct Authority has full regard to the needs of vulnerable consumers, particularly those who may be disadvantaged in various ways. That is missing at the moment.

Q144 Lord McFall of Alcluith: Do you think financial inclusion should be an objective of the FCA?

Christine Farnish: Or a qualifier to the consumer protection objective would probably be right.

Q145 Lord McFall of Alcluith: I am thinking of, say, the Royal Bank of Scotland which made an announcement a few weeks ago that it would withdraw the facility for basic bank accounts with their ATMs. We have a free ATM network, but what that will do in my opinion eventually will interfere with the interchange fee. Therefore, there will be a structural issue there and the whole system can come down with others following that. What do we do with those systems?

Paul Lewis: I think you could say it was anti-competitive, and it is appalling. I believe Lloyds do it too. They do not allow basic bank account customers to use other banks' ATMs. They have to use only the ATMs of that bank. I think it is anti-competitive. If you were being really cynical you might say it was because they do not really want basic bank account customers, so let them go to another bank. Competition is fine. There are people who use websites, churn their stuff and move from one to another. We are all quite well served, but those who do not have easy access to the web and the credit rating to move their debt or current account all the time must also be protected. It is more about protection than financial inclusion.

Q146 Lord McFall of Alcluith: So, what do we do with this legislation?

Martin Lewis: We must have some responsibility. We talk about most people being financially illiterate. You then have those at the very bottom who will never be capable of understanding the product. The statistics show that 49% of individuals, or their partners, who have had mental health issues have had debt crises compared with 9% of the rest of the population. To me, that is a shocking statistic. You are five times more likely to have debt crises if you have mental health issues. The job of banks is to make money from you so you have to be responsible for yourself, but we must protect those who are not capable of being responsible for themselves either temporarily or over a longer period, whether it is due to mental health or mental capacity. Gillian uses the phrase "all consumers", so we are not talking just about competition; we are talking of the bottom end. That must be included in the Bill so people are protected in future.

As to basic bank accounts, we take it back to the bigger step. Banks do not want basic bank accounts. If you apply for a bank account and tell them you have a poor credit file they give you a current account form. If you are rejected they do not have to give you the basic bank account; they say, "Sorry; you've been rejected." I would impose an obligation that if you are rejected they must offer you a basic bank account. In this country we have one million people without bank accounts. It would be relatively easy to put in that regulation to fix it. We should mandate the FCA to look at that, changing small regulations that help people by financial inclusion.

Q147 Lord McFall of Alcluith: Gillian, would you agree with that given all the problems you have at local level?

Gillian Guy: The cost of financial exclusion goes way beyond financial institutions and what we are talking about here, because it also takes us into the social costs of housing, education, health and all those things. We have spent a long time at Citizens Advice trying to persuade the banks to give basic bank accounts to undischarged bankrupts, because they cannot get back into the system at all. If they get work they cannot have their pay put into an account anywhere because everyone pays through banks. We also find it enormously difficult to get that acceptance through the BBA. We think that this is an opportunity to put in a

mandate to say that financial inclusion must be an objective and is clearly within the legislation and regulatory framework.

Q148 Lord McFall of Alcluith: On the issue of competition, I note this week that in the Vickers report there are quite good proposals on switching but an absence of current account portability number. Without that I do not think much will happen with it. Is there something we should be doing here?

Christine Farnish: The difficulty here is that you are talking about changing some of the biggest IT systems in this country, if not the biggest, and that cannot be done in a short time scale. It is perfectly reasonable to set that as a longer-term objective and probably demand it.

Q149 Lord McFall of Alcluith: With the objective of 2019 like the rest of it?

Christine Farnish: It is certainly worth studying the cost benefit of setting some sort of target like that.

Peter Vicary-Smith: Mobile phone switching took off in this country only when numbers became portable. All the way through it the industry said it could not do it because of the problems. The regulator said they had to do it anyway. I cannot remember the number of years. They said that when they next upgraded their systems they would impose upon them an obligation to include that. That is where we should go. They are changing all the time. HSBC is in the middle of a large changeover now. Lay it upon them that next time there is an obligation on them so that in 10 or 15 years' time, whatever it is, it is there for future consumers.

Paul Lewis: The work that Vickers suggested is supposed to happen within two years, September 2013. If you leave it for another six years until 2019, surely they could have portability. Portability is the mechanism, but you also must have an understanding of the terms on offer. Where I do think Vickers has got it wrong is to say that the interest you are losing is bank rate minus whatever they pay you. That is nonsense. They do not lend money at bank rate but at LIBOR. It should be a lot more than that if you are to see what you are really losing from having a balance in a current account.

Q150 Mr Brown: We have in part touched on the issue of redress. Rather than invite you to repeat what you have already said, how easy is it to get redress for consumers who have been wronged by the system? Can you say anything to us about the structures through which you have to work? You mentioned the ombudsman earlier.

Martin Lewis: The funny thing is that the ombudsman tends to be much better at looking at the wish and the will of consumers than the regulator. The problem with the ombudsman is that there has been an explosion of work in recent years and it is struggling with staffing, especially PPI. There is a two-part system set up. First, you must first go to the bank and then the ombudsman. The problem is that the banks traditionally have seen that as an opportunity to do everything they can to stop the consumer going further. I have read those letters. They are beautifully drafted to ensure that they fulfil the requirement of telling you about the ombudsman but give you no hope whatsoever that you will actually succeed. It is an overly-litigious form written by a clever lawyer to tell you how you go forward. People cannot even write letters.

Q151 Mr Brown: My question is: what would you ask us to do about it?

Martin Lewis: I would have the ability to complain much more quickly and banks must have an obligation upon them to solve complaints effectively and efficiently without going to the ombudsman with a view to pry up ombudsman's decisions. That would be the

way that I would solve the issue. Therefore, if they do not do that the ombudsman becomes an appeal court, but it is effectively setting precedent and the judgments of the ombudsman are publicised, which we tend not to see at the moment. Again, there is no transparency. Why can't we find out how the ombudsman makes these decisions? It is a quasi-judicial process, but it is a much better and more efficient system. The problem is that redress is very complicated; people do not know how to do it. Very limited help is available. We can publish template letters, but the ombudsman tends not to like them. People are very bad at writing letters to their banks. They get very scared.

Q152 Chairman: The question was: what should we be doing about it?

Martin Lewis: You should be making sure that when a complaint is made to a company it must look at redress with a view to what the ombudsman has decided in the past so there is some precedent as to how a decision is made. There should be redress on those lines, not on its own views.

Chairman: That is very helpful.

Peter Vicary-Smith: I would add two specific points. One is about resisting industry pressure to water down the powers of the ombudsman. There is a concerted campaign now going on to make the ombudsman less effective. We always need to resist that, because it is a hugely valuable tool for consumers. The second thing is that I would like to see all financial institutions do what some already have done, namely that the bonuses of the senior management team include an element for customer complaint reduction, not to be passed on to the ombudsman but to drive down customer complaints. Some have done that already. Then you will start to see far more attention being paid to customer complaint levels if it hits their pockets.

Paul Lewis: It is trying to change the culture so they want to resolve them. If somebody from the Money Box team or myself rings up a bank the problem is solved like that, yet somebody might have been waiting six weeks to get it solved. It is the culture in the complaints department that must be changed, so give them bonuses for the number of people they pay out rather than the number of complaints they block. Something must be done. I am not clear about the legislative procedure, but something should be done to change that culture.

Gillian Guy: Perhaps I may sound a note of caution on the number of complaints resolved being the determinant of bonuses, incentives and the like. If organisations encourage complaints and therefore want to see a volume of them in order to resolve them that gives rise to consumer care, if you like. I also stress that part of the FCA's objective should be about deterrence and redress so it is part of the conduct and regulatory framework to make sure the obligation is articulated, as opposed to it being just left to the companies themselves. Indeed, it is one of the reasons why we would like to see consumer credit transferred to the FCA, because at the moment there is no power of redress.

Chairman: We have already dealt with that issue. I am sorry to cut you off but we are already overrunning, which is why I am having to be rather rude in this way.

Q153 Mr Mudie: I am sorry to take you back to it, but I am disappointed that the four of you have not picked up on Consumer Focus's strong paper on accountability. It is inevitable; you do not get much opportunity to speak for the consumer in public before Parliament. What Consumer Focus is saying is that this Bill gives unelected individuals unprecedented powers with accountability reduced to retrospective reporting. These powers will affect employment and growth and will have great social consequences. It is not even accountability. The only way to influence them has been taken away because it is

retrospective. The governor will come here and tell us what he has done and why. He will not say, "Do you think I should be doing something different?"

To give an example, in the case of RDR when we had Hector Sants of the FSA in front of us—it was something that caused real upset in the country—the Committee gave him a really hard time and he did not give very adequate answers. When we said publicly, "Will you have second thoughts about this? Will you review your decision?" he said, "No. I have the power." But we said, "We're democratically elected; we represent the people and we're asking you to do it." He said, "If you give me evidence I will consider it." That is operating now. This pushes it much further. Consumer Focus has spelt out the dangers. Do you not understand, or would you comment on it?

Peter Vicary-Smith: There are a couple of things. I absolutely agree. Our failure to come to it yet was not that we saw it as unimportant by any means. There are really two intertwining things: accountability and governance. We absolutely agree on accountability. Indeed, the FSA had woefully inadequate accountability to Parliament. One of the things we have talked about in the past is that really only the Treasury Select Committee seemed to be holding the FSA to account. We have said that publicly. Therefore, accountability to Parliament is really important. To be accountable the strategic objective needs to be right so Parliament knows what to hold it accountable to.

The other dimension is about the governance and interventions before then. We want to make sure that the decisions have those inputs from outside the group. For years we have gone on about the FSA having at one point 10 of the 12 members of the board being from the industry, including the chief executive of HBOS sitting on the board at the same time as his firm is being regulated by the FSA. That sort of nonsense is helpfully going away, but it could still be there within the Prudential Regulatory Authority. It has no requirement about representation on the board of the PRA, or indeed about having a consumer panel that can give these inputs. There are three dimensions: get the objectives right; ensure accountability to Parliament is strengthened, as has been talked about, and get the governance arrangements right in both of these major bodies so there is less to worry about downstream.

Q154 Mr Ruffley: All of you seem to be saying in your powerful evidence that safety should be a given, like people who sell food or cars. We have got that. Is there any foreign country with a regime of product regulation that delivers that safety as a given in financial services products? Are there any models abroad at which this Committee could look?

Paul Lewis: Not that I am aware of. The answer is that I just do not know, but what you have to consider is whether there is any foreign country that has a financial services industry like ours. The answer to that is probably no.

Martin Lewis: I think they are incredibly dominant in this country. We have a large number of complex products.

Q155 Chairman: Are there any foreign examples?

Martin Lewis: Not that I can think of, even in the States.

Christine Farnish: Certainly, in the States there are measures for consumer credit products which have been introduced relatively recently, from which we might be able to learn. In some European countries there are some quite strong product regulatory regimes. They are different from us in a number of respects, but we could also look at other sectors. The energy regulator is looking very closely at the confusion of tariffs and all the rest of it in energy markets, and is thinking now about how to move towards more common or minimum standards and greater clarity and simplicity for consumers. I think regulators need to get together on this issue and learn from each other. There is valid experience out there.

Paul Lewis: The States introduced a new regulation system after the crisis. As I recall, their equivalent of what we will call the Financial Conduct Authority is for consumers and nothing else. I think that would be a model worth looking at, though I cannot tell you the detail here.

Peter Vicary-Smith: Some work has been done on this by Consumers International. I cannot bring it to mind, but perhaps I may write to the Committee subsequently.

Chairman: That would be very helpful indeed. Thank you all very much indeed. This has been an immensely valuable session. When prior to our public sessions we started to consider how we should focus our attention we diagnosed that there had been a problem in the public debate. The focus on preventing another banking crisis was in danger of crowding out the important aspect of consumer regulation in the Financial Conduct Authority. We resolved that we would not make that mistake. Even if we had not, you would have prevented us from doing so. We are very grateful to you for the powerful evidence you have given, both orally and in writing.

Examination of Witnesses

Witnesses: **Mark Neale**, Chief Executive, Financial Services Compensation Scheme, **Natalie Ceeney**, Chief Executive and Chief Ombudsman, Financial Ombudsman Service, and **Tony Hobman**, Chief Executive, Money Advice Service, examined.

Chairman: Thank you very much indeed for coming today and your prior evidence to the Committee. I am sorry we overran the previous session which means we will have rather less time than we hoped to talk to you. I hope, therefore, that questions can be pithy and that, to the extent it is possible, answers can also be kept brief.

Q156 Lord Newby: Under the proposals two regulators, the PRA and FCA, will have responsibility for rule-making powers over the FSCS. How do you think you will deal with the issues of co-ordination between those two bodies?

Mark Neale: I think accountability to both PRA and the FCA makes very good sense because it reflects the important role we play in the resolution arrangements for the failure of major banks, building societies or other systemically important financial institutions. Equally, we will have important accountabilities to the FCA for the protection of consumers when other financial businesses fail. Therefore, accountability to both bodies looks right to us. I see no great problem with making those relationships work. We have good relationships now with both the Bank of England and the FCA, and I would expect the memorandum of understanding that will be put in place to underpin a continuation of those good working relationships.

Q157 Lord Newby: So, you think your working relationships with them will continue to be good and you are not concerned, as some people have been, that the relationships between the PRA and FCA might cause problems?

Mark Neale: Clearly, it will be very important that the PRA and FCA work effectively together. Again, the legislation provides for the existence of memoranda of understanding to underpin that relationship, but at the end of the day the working relationships are what actually matter and I would expect them to be close and effective.

Q158 Mr Mudie: I have a question about your charging. The compensation scheme was set up hurriedly and it was going to be reviewed. There is general unhappiness. I am not

sure the review has taken place. Do you intend to change it to meet the genuine complaints made, because it is a disparate market, is it not?

Mark Neale: You are absolutely right. There are concerns within the industry about our funding arrangements prompted by the heavy demands we have had to make on the industry to finance compensation for the key data failure and also PPI failures. We are very conscious of that. Clearly, it is important that the industry funds us, but it is also important that the funding arrangements themselves command maximum support within the industry. There is a review in place led by the Financial Services Authority, but, quite rightly, the FSA put it into suspense until we were clear how European Union legislation on deposit protection would come out. It is quite likely that the European Union legislative process will complete in the second half of this year. I would very much hope that the review will be able to start up again and we can see whether we can move to arrangements that command wider support within the industry.

Q159 Mr Mudie: That is helpful. You say that they have been making these complaints, justifiably, for a considerable time. These are dire times for firms, especially the smaller ones. You are waiting for the legislation and then you will do a further review. First, can you give any assurances that that review will be quicker than the last one? Second, I worry about your terms of reference "command maximum support". Firms in some of the smaller niches are being hammered by this. There is a need for sensitive compensation scheme charging that reflects the different sizes and finances of the firms involved. Is that going to be a prerogative, rather than just commanding maximum support and the minority can lump it?

Mark Neale: No. I think you are absolutely right. It is very important that the arrangements are fair to smaller businesses. Certainly, those businesses would argue that they would like to see the funding arrangements better reflect the risks that particular sectors of the industry impose. In answer to your first question, once we are clear on the European legislation, which essentially will determine whether we have pre-funding for deposits, there is a general view that we should move as quickly as we possibly can. That would certainly be my view.

Q160 Lord Maples: One of the suggestions made by Vickers, if I understand it correctly, is that insured deposits should have priority in a liquidation. Presumably, it would mean that, unless the bank was so insolvent that it did not have enough money to meet that, which seems unlikely, with the loss buffer of about 20% that Vickers is talking about these losses will no longer have to be spread around the banking system, they will fall on the shareholders and other creditors of the bank. Does that solve the problem?

Mark Neale: I do not think it solves the problem. You are absolutely right that it will facilitate our role in recovering the costs of compensation from the estate of the failed bank or building society. Clearly, there are time lags in the insolvency process. We are committed to paying out the great majority of depositors within seven days of a failure, so although deposits are a priority—it will help us maximise the recovery we make from the estate of the failed business—inevitably there will be a lag.

Q161 Lord Maples: As I understand it, you do that at the moment. You would finance that immediate payment by borrowing the money from the Treasury?

Mark Neale: Not necessarily. We certainly did borrow from the Treasury during the 2008 crisis because of the scale of the compensation costs we were being asked to meet, which rose to about £18 billion. For much smaller failures we would expect to make a levy on the deposit-taking sector immediately.

Q162 Lord Maples: But the deposit-taking sector would presumably much prefer the arrangement proposed by Vickers than the one it has at the moment, because it would solve the problem about which Mr Mudie has just asked and which I experienced as a constituency MP, namely that small, conservative and well-run building societies feel that they are bailing out the irresponsible and more risky organisations?

Mark Neale: I am not sure it would immediately solve their problem, because for small and medium size failures we would certainly raise a levy in the first instance in order to meet the compensation.

Q163 Lord Maples: But they would get their money back?

Mark Neale: Yes.

Q164 Lord Maples: The deposit protection scheme used to pay the first £2,000 and then 10% of the next whatever it was. I have forgotten what it was. It was £38,000 or something like that. It is now 100% of the first £85,000?

Mark Neale: Correct.

Q165 Lord Maples: In the context of competition, have we now given an unfair advantage to the risky organisation, the Northern Rock, where people can take the slightly higher interest rate than they might have got from, say, Nationwide or Barclays, and are financing a much riskier organisation but are not bearing any of the risks at all; it is all borne by the Financial Services Compensation Scheme?

Mark Neale: Arguably, you have pointed to what economists would call a "moral hazard" problem.

Q166 Lord Maples: I am being told not to use jargon in this Committee.

Mark Neale: I would make two points in response to that. First, financial stability is very important and if consumers feel they have any money at stake that is likely to lead to the kind of scenes we saw when Northern Rock was in trouble, which in turn added to the financial instability of the period. Second, I question whether consumers are in a strong position to make judgments about the creditworthiness of banks and building societies.

Q167 Mr Brown: When you make a finding, how easy is it to get a remedy for the people whose cases you have upheld? In your relationship with the regulator how responsive is the regulator to your findings? In particular, people who come to see their MPs always say they are not doing it for themselves but to make sure it never happens again. How responsive is the regulator on the "it will not happen again" point?

Natalie Ceeney: Let me start with the firms and then move on to the regulator. We see complaints only when the firm has already had a period to get things right. We often take a very black and white view of firms. I see very good and abysmal firms. As to the very good firms, best practice would be that for any complaint coming to the ombudsman the firm has already considered it at board level. Frankly, we tend to find in their favour in the majority of cases because they have done it properly. We also have some firms where we find against them virtually on every occasion. To give an example, there is one major firm that I will not name which, for three weeks, we have not even found someone to answer the phone because it has carried out some staffing changes. As a result, we have found no one to talk to. Therefore, we do see the abysmal.

As to our relationship with the regulator, things are now changing, but we have had a period when we have seen it very slow to get action. Repayment protection insurance is a

classic example where we started to see very high volumes of cases about five years ago, and we became increasingly vocal about it. It was only very recently that we obtained clear guidance on what to do. We are beginning to see that change, but for us one of the biggest issues is that when we see systemic issues—not much of what we do is a systemic issue—we want early intervention.

Q168 Mr Brown: And the regulator?
Natalie Ceeney: That is really in relation to the regulator.

Q169 Mr Brown: My question is: do you get it?
Natalie Ceeney: The honest answer is that it varies. Over the last five years we have had quite big problems. If I may talk briefly about PPI, it has been 20% of our work in our 10-year history.

Q170 Mr Brown: I was struck by the volume of work you are carrying out in a year. I had not realised that until I received your briefing.
Natalie Ceeney: It is quite staggering. In our 10-year history just three issues have accounted for half of our work: complaints about the mis-selling of mortgage endowments, complaints about mis-selling of payment protection insurance and bank and credit card charges. For five years we flagged that we had seen increasing volumes of PPI complaints and that in our view it had gone beyond individual complaints to a systemic issue. The regulator was very slow to act. To be fair, some of the banks also put every obstacle in the way to act. That has been a concern. In individual cases where it is really about talking to the firm to get a remedy, that is what we do. Where there is a systemic issue we rely on the regulator to take early action. It has not been a strong point with the FSA for the last five years, but I am starting to see that culture change within the FSA.

Q171 Mr Brown: The point about culture is made to us a lot. Should we be looking to strengthen your hand with the regulator or the regulator's hand with the regulated?
Natalie Ceeney: Both. I think the big gap over the last five years has been to do with our starting to see issues. Our role is simply to decide individual complaints. We are not a regulator, and I do not want to stray into that space. But when we start to see the same issue again and again we want a regulator to say, "There's an issue and we'll step in." On PPI there was a big gap. We would be looking for far earlier intervention by the regulator.

The regulator got some new powers under section 404 in the last 12 months to be able to do industry-wide redress schemes. They have used those powers three times. We really welcome that. There are instances where an industry-wide redress scheme is the right answer rather than everything coming to the ombudsman. One other issue is whether there have been enough consequences for firms in getting wrong complaint handling. One issue that I know the consumer groups have just raised is transparency. We are very pleased with the provision in the draft legislation which will allow us to publish ombudsman determinations. We think that to make transparent what we are seeing will help raise the stakes and help people to take our complaints seriously. We also think it is quite important that the issue of a super complaint is debated to allow consumer groups and others to raise where they see a systemic issue and get it more firmly on the regulator's agenda earlier.

Q172 Mr Brown: These published findings will not be anonymised?
Natalie Ceeney: After consultation with the Treasury—it is out for consultation now; in fact it went out last Friday—we are asking for the views of consumer groups and industries alike on what should be redacted. Our view is that we should not publish the names of

consumers, because they come for a solution and we would not want to disadvantage them, but it would be wholly impractical to redact the names of firms. You would end up blanking out half the decision, but we really are taking views over the next few months, so that at the point the legislation is introduced you can inform Parliament about the views of industry and consumer groups alike and take a view on that.

Chairman: I want to ask about a point that came up in the previous session. I do not know whether you heard it or were out in the corridor.

Natalie Ceeney: I did. I heard it.

Q173 Chairman: It was said that redress procedures took too long and that consumers should be allowed to approach you earlier in the process than is currently the case. Could you comment on that?

Natalie Ceeney: It is important that consumers can get their problems sorted out by their firms first. To give you a slightly shocking statistic, at the moment the big banks have eight weeks to resolve a consumer's dispute. Of the cases that are referred to us, over half of the consumers have not received a final response within that period. Therefore, if we can solve one thing it is to get better complaint handling by firms. It is better for the firms and consumers that they can raise an issue quickly and have it dealt with quickly. In a way, we were set up to be a back stop, and that is what we think we should be. We already offer a service where consumers can phone us, even if they have not complained to their firm. What we will do is talk through with them how to complain to their firm and often explain to them how the process works. We are not seeking earlier intervention powers. I would like firms to handle complaints properly.

Q174 Chairman: How can that be brought about if they are supposed to do it within eight weeks at present but half of them do not?

Natalie Ceeney: Quite a lot has happened over the last couple of years which might give an indication. As we have started to publish data as the media has paid more attention we have seen more and more senior people within firms get interested in complaint handling. There is more transparency about what we are finding and the data about complaint handling. As to data about firm behaviour—for example, we talk about banks as if they are all the same—in the case of one large banking group, at the moment we find against it in two thirds of cases. In the case of another large group, they win in two thirds of cases. They are not all the same. The more that is apparent the more it will help firms improve.

There is more that the regulator can do. They have started to fine banks for poor complaint-handling behaviour. We would welcome more transparency from the regulator about findings and, frankly, more consequences for getting it wrong, but the focus must be improving the way firms handle this themselves. I stress that there are some very good ones and others where the performance is, frankly, abysmal.

Q175 Lord Newby: Do you publish the relevant statistics?

Natalie Ceeney: We do. Every six months we publish both the volume by firm and what we call uphold rates by firms, ie win/lose rates. They are quite telling. Within any product area you will find firms that, frankly, do very well and those that do very badly.

Q176 Chairman: So, you publish which firm loses two thirds and which firm gains?

Natalie Ceeney: It is in the public record, yes.

Q177 Chairman: In that case, can you tell us the names?

Natalie Ceeney: I can. In the last published data of the big banks, Lloyds Banking Group lost two thirds of the cases they referred to us in that period and HSBC lost only a third, but I stress that, if you look at our data, building societies as a group lost only 22% of cases, and some firms lost every case they sent to us. It varies significantly by firm.

Q178 Mr Brown: That rather reinforces the point that has been made to us throughout the morning about the culture in individual institutions being as important as structures.

Natalie Ceeney: Absolutely.

Q179 Mr Brown: Is it possible that a bank would reject cases almost as a tactic and hope that the customer did not then appeal?

Natalie Ceeney: Unfortunately, yes. If I may talk about one instance in the public domain. One large banking group was selling a very risky investment product to unsophisticated deposit account-holders. We had to see complaint after complaint, and it was only when a group of those customers approached Parliament and the media got interested that that big bank started to settle complaints. We had 500 of those cases and we found consistently in the same case. I was having conversations with the retail chief executive saying, "Nothing's going to change; we'll keep finding that selling this highly sophisticated product to unsophisticated investors is, frankly, wrong." It took media intervention to resolve it. Unfortunately, we see that quite often.

Q180 Baroness Drake: Natalie, your submission expresses optimism that the proposals in the Bill and other changes will strengthen the early identification of issues prior to intervention, and the range of regulatory powers will reduce mis-selling. Your submission uses the word "optimistic", but we know from other submissions that there will be unhappiness among firms on two particular matters: first, that they cannot appeal the decisions of the ombudsman, whereas the consumer has a choice between accepting it and going to court; second, if it is clear that they have complied with the FCA and guidance they should not have what they consider to be inconsistent redress imposed upon them because that is making the ombudsman in effect a semi-regulator. Given that we will probably meet those comments how would you rebut, or even sympathise with them?

Natalie Ceeney: I talk to industry a lot. Those views are not held by the majority. There is a segment of industry that would quite like to weaken the role of the ombudsman, so it has to be looked at in that context. We have an appeals process. The ombudsman has a two-stage process. 80% of our disputes are resolved at the first stage. If anyone is unhappy they can go to the second stage, so there is an inbuilt appeals process. We can then be judicially reviewed. That is something that is used. We have about 20 judicial reviews a year. It is a power that is actively used. Parliament set us up to be an alternative to the courts, so if what happened was simply after the ombudsman things went back into the bottom of the courts system we would not be an alternative to courts; we would be a piece of bureaucracy added to the court system. In our view there is an inbuilt appeals system.

Q181 Baroness Drake: You said that judicial review is a process that is actively used. Can you give us any quantitative statistics to illustrate that point?

Natalie Ceeney: In any one year we are judicially reviewed up to 20 times. The most recent high-profile example was the BBA's judicial review against us and the FSA on PPI. The High Court judge found in our favour and the FSA's on all counts. We have a good track record of winning judicial reviews, which I think should give the system confidence that we do our job pretty well.

To address the second point, we are very keen to give industry confidence and transparency on what the ombudsman will find. We have done a lot of work over the last few years to make our approach very public. Lord Hunt reviewed us three years ago. One of his recommendations was that we should put on our website pretty much all the internal guidance we use derived from case law to judge cases. We do that, so that is out there. He also recommended that we publish data, which was the birth of the data we now publish. We run a helpline for firms. If any firm is confused about what we might do in a case it can call. I actively talk to industry about any confusion. I am very keen that industry does not misunderstand about what we do.

Neither the FSA nor any regulator can lay down absolutely every scenario in the rules. That was the issue in the recent High Court case, in that firms said, "Where in the rules did it say we couldn't sell PPI?" The High Court judge essentially decided that the FSA rightly had principles about treating customers fairly as well as rules and firms had to follow principles as well as rules. If firms follow the law, the FSA's principles and rules it is extremely unlikely we will ever find against them. For example, nowhere in the FSA's rules does it say you cannot swear at or punch a customer, but if I have a case where a member of staff at a branch had sworn and punched a customer you have a pretty clear indication of which way I will find in that case, and the defence "Where in the rules does it say I can't do it?" will not hold a lot of sway.

Q182 Mr Ruffley: I have a question for the chief executive of the Money Advisory Service. What percentage of the public know of your existence and what you do as an organisation?

Tony Hobman: Relatively few at the moment. We were born out of the 2010 Act with the prosaic title of the Consumer Financial Education Body. We had the task, in which we are still engaged, of transforming ourselves into something that would resonate with the public in terms of what it is we say we are doing, hence the new title, and also having a rather more effective suite of products and services than was the case before. We have embarked on that journey only having been relaunched as the Money Advice Service only since June of this year with our financial health check. We probably have an unprompted brand awareness of about 10% of the market at the moment.

Q183 Mr Ruffley: You have been badged with doing something slightly different. What percentage of the great British publish do you reach? Presumably, you put out opinion surveys because you are a public-facing organisation; indeed, I read from the submission that you give advice to members of the public. Will you do any work to find out who knows about you, and what progress you are making?

Tony Hobman: Yes, absolutely. We have just started the journey, but it is clear to us, without being over-critical of what went on before—much of what was done was under the so-called Delivering Change strategy, which was really the umbrella for financial capability under the FSA up to last year—a lot of information was produced and leaflets and booklets were handed out, but there was not necessarily action and change in behaviour on the back of that. It is a very new model. What will be important to us, which we will measure going forward, is not just the amount of reach we achieve—we have to reach many more millions of people than was the case before—but what they do as a result of having contact with us.

Q184 Mr Ruffley: How are you as chief executive going to measure the success of your organisation in the next 12 months?

Tony Hobman: I already have some clear targets within the context of this year which are about the numbers of people who are reached with our new health check. We hope to

reach 500,000 by next March with an inherited impact measure that, of those who have some contact with us, at least 8% will go on and do something as a result. We would expect to set targets going forward—we have not done it yet; we are in the process of working it out—that are much more significant than that. For example, Delivering Change probably reached of the order of 10 million people.

Q185 Mr Ruffley: How do you define "reached"?
Tony Hobman: I do it by my earlier rather weak definition.

Q186 Mr Ruffley: They have heard of you?
Tony Hobman: Yes, or they have been given something by us. I would expect in the medium term—maybe the very few years ahead—to be reaching that number of people in any one year, which is a quantum factor looking ahead, and also significantly to improve our impact. We have not measured it yet, but we need to have a longitudinal study of how much people's confidence, understanding and ability to manage their finances is growing. That is about measuring a change in a social norm in a sense, but that is something we can do.

Q187 Mr Ruffley: So, it is a matter of a social norm and qualitative analysis?
Tony Hobman: It will be positive as well. It absolutely would be quantitative. I think you can ask questions. Indeed, there was a very large-scale baseline study done by the FSA at the beginning of the process which said, "These are the questions you can ask people which seem to indicate the degree to which they have financial capability or confidence", and you can go back over time and ask those questions of a population that has had contact with us and a wider population as a sort of control to see what difference we have made.

Q188 Mr Ruffley: In the interests of transparency, I take it you will be publishing your targets and your progress against them?
Tony Hobman: Indeed we will, yes.

Q189 Mr Ruffley: I read in your submissions that you want to become a more advice-oriented service, so education and information is a given. Can you describe what you mean by "more advice-oriented"? Subsequent to that, if advice is being given what can you tell the Committee about the quality of the personnel dispensing the advice in your organisation? Who are they? From where are they recruited?
Tony Hobman: The important distinction I would make is that we do not seek to provide regulated advice, so we are not advising people which company's product they should be purchasing, although through our comparison tables they could eventually find their way to those products. We are providing more directive advice than simply saying, "Look, here's the information. Make of it what you will." We will be prepared to talk to people about whether and how they could budget more adequately than they have, what risks are inherent in certain types of products and indeed whether they might want to think of getting more specialist advice. We also hand on a lot of those who contact us to the free-charging advisory community. I am very clear that we can do more than simply provide information under the umbrella of the term "advice" which is not a regulatory term but one that ordinary folk understand.

On your question about standards, within the context of not giving regulated advice we have very clear and strict protocols for those people who man our phones or give face to face advice. Of course, the material that goes on our website is monitored and has to meet a standard, which is regularly checked.

Q190 Mr Ruffley: If someone rang your advertised telephone number and said, "I don't understand my American Express monthly statement and why I'm being charged this rate of interest for an uncleared balance, or portion of a balance", your staff would get into that?

Tony Hobman: Yes, they would. Clearly, a huge number of queries of that nature, which are more or less complex, could be answered by them or they could direct the person to someone else who could. In many cases the inquiries will relate to debt, for example, where people are better served currently by going to specialist debt advisers.

Q191 Mr Ruffley: Some people in the industry have indicated to the Committee that there are organisations other than yours that already provide website price comparison services. Is there any degree to which you are reinventing the wheel and duplicating efforts better done by other existing price comparison services?

Tony Hobman: I do not believe so.

Q192 Mr Ruffley: Why so?

Tony Hobman: I will explain. First, we know from the research we have done that to reach the number of people we intend we must have their trust; they must want to relate to us, and the aspects of our service established by the Government, being free and not relying on a commercial model for our income, are important to them. It is important that we have a suite of products branded as the Money Advice Service which they know are ours.

The other point I make is that there is enough room for us all. We know from research done last year that only 11% of people look at comparison tables, for example, which you have mentioned. That tells me there is a job for us to do and for others too. A lot of potential has not been met in the market. I think there is room for all of us.

Q193 Mr Ruffley: There is reference to co-ordination agreements with the FCA, which will be the subject of a memorandum of understanding. Can you describe what that will cover?

Tony Hobman: We have an MOU currently with the FSA which talks about the way in which and the frequency with which we will talk to each other and the topics on which we would expect to liaise. I would hope to take forward the core of that. One thing that is different about the world ahead, and therefore characterises our relationship with the FCA, is that because of the relationship with this very large number of people we will have a unique and important body of consumer feedback on the things that are issues to them. That will be pre-detriment in a sense; that is the missing part of the jigsaw at the moment. It is not when things have gone wrong but the things that people are talking and asking about which suggest they already have issues. I would expect that within any memorandum of understanding with the FCA it is important we project that information to them and they listen to it.

Q194 Mr Ruffley: I put one sneaky question to the financial ombudsman and chief executive. You may or may not have heard the evidence of Martin Lewis earlier. He said it would be hugely in the interests of consumers if when a complaint was made against a company for that financial service firm to be aware of previous rulings by your service and take account of the precedents established by your service when determining an intra-company complaint. That seems a bit of a no-brainer. Is there any mechanism you can see in this legislation that will deliver that objective?

Natalie Ceeney: In many ways that is already there. The FCA rules already say that firms ought to have regard to previous rulings. Of course, firms see the individual rulings, so in many ways that should have been happening and has not.

Q195 Mr Ruffley: But Mr Lewis was quite clear that it was not happening and you can infer it is not happening from quite a few of the statistics.

Natalie Ceeney: There are certainly some firms that are not paying regard to what we have done in the past. I think it is more to do with culture than rules. One thing that will help is inclusion in the Bill of an obligation on us to publish all ombudsman decisions. One issue is that firms should learn from themselves, but it would also be good for the financial services sector if they all learned from one another's mistakes. We really welcome that inclusion. Going back to some earlier comments, greater transparency can rebuild and not reduce confidence.

Q196 Lord Maples: On this point, Martin Lewis went a bit further. He said that if a firm had been found against by you and continued to reject the same complaint from other customers you or somebody should have power to fine them or impose a sanction against them. Is that feasible?

Natalie Ceeney: To some degree, the FSA have been able to do that and started to do it. In the last 10 years they have levied £10 million of fines on financial services firms for poor complaint handling. We do need to keep upping the stakes on bad complaint handling because there need to be more consequences for getting it wrong. Fines help, but my view is that the more transparent we are and the more publicity is given to it potentially it will have an even greater impact.

Q197 Baroness Wheatcroft: However hard the industry tries, inevitably there is an asymmetry of information between financial services providers and clients. There is a power under the new regime to ban certain products, but I wonder how extensively you would like to see that used and where the balance between caveat emptor and the provider should be. For instance, Paul Lewis was adamant that endowment mortgages were so dangerous they should never have been sold to anybody. There are people who would take a very different view and did very well out of endowment mortgages. Where do you see the balance?

Natalie Ceeney: A lot of products sold are suitable for some people but not all. The sorts of issues I see are those where products designed for sophisticated investors are sold to the unsophisticated in an inappropriate way. Tackling the sales end and the sales culture is in many cases more appropriate than necessarily looking at products, because well-designed products can be sold to the wrong people. There are other leading indicators. If you look at mortgage endowments, one of the big issues was that it became the dominant product sold. I agree with you that it was very suitable for some people and highly unsuitable for others, but when it becomes almost the only show in town and everybody pushes it you start to worry. The same trend occurred in PPI. It was pretty hard to buy a loan without somebody saying, "Of course you need PPI." The other indicator is that I have heard a leading insurer say that when you start seeing margins of 90% on a product alarm bells should ring. Most products are suitable for some people. Take the issue raised earlier about some of the complex mortgages that are in the market at the moment. When we look at complaints in those cases often our view is that they are fine as long as they are sold with advice and suitability is very carefully assessed. When that is not done we start to have concerns.

Q198 Baroness Wheatcroft: It sounds as if you would hope that a product ban would be quite a rare thing.

Natalie Ceeney: Yes. To take PPI again, in the end mis-selling was happening so widely that there was a ban on the sale of single premium PPI. I think that was the right decision because so much history had happened to make it the right decision. It also comes

back to another theme of this debate. We have to get the culture right so it is not constantly stopping things after the event but these things do not happen in the first place because the pervading culture in financial services is that customers should be treated fairly.

Q199 Baroness Drake: In response to the question about advice, you said there were circumstances in which you handed on those who raised queries to the fee-paying community. How do you do that?

Tony Hobman: If they were speaking to us on the phone or face to face we would conceivably transfer them there and then, but it is more likely we would put them in contact with someone like unbiased.com which is the umbrella organisation for IFAs so they could find an IFA where they lived.

Q200 Baroness Drake: Do you run a panel or list of IFAs? Do you get engaged in preference?

Tony Hobman: We use IFAs in the development of our material.

Q201 Baroness Drake: But when you are handing over the people.

Tony Hobman: If you went to our website and, as a result of using that information, it was clear that it was something you might want to explore, we would have a gateway into the advisory community, but we would not list every single one. This may be a point about recycling some of the other materials available in the commercial world. There are several good portals into the advisory community.

Q202 Baroness Drake: What I am trying to get at is: can you be certain that IFAs do not get preferential access?

Tony Hobman: If that is your point, absolutely not. We do not recommend one IFA above any others.

Q203 Lord McFall of Alcluith: Mr Hobman, what is your budget for the current year, and what is the projection for the next three years?

Tony Hobman: Our current budget is £47 million. We are absolutely in the middle of setting our budget for next year. I cannot give you a definitive figure yet, but I would expect it to be of the same order of magnitude for the preventative work we are doing. There is another task, and therefore cost, on the horizon. The Government have asked us to take over the co-ordination of debt advice. Currently, the face to face contracts, which were run by BIS through Citizens Advice, are of the order of £27 million. There is a clear indication that if we took those on a somewhat greater amount would be needed.

Q204 Lord McFall of Alcluith: Are you content that with a combined budget you will be able to carry out the task?

Tony Hobman: Yes. To go back to what I said earlier in response to Mr Ruffley's questions, without being over-critical of the past we can get a lot more bang for our buck by being smarter about what we do and how we do it.

Q205 Lord McFall of Alcluith: I had personal experience of PPI in 2005. I went into Barclays Bank and they offered it to me. I did not need it. I got eight letters after that. I reported it to people. Five or six years later they dragged it out until we got to this stage. Natalie, will this Bill help in a situation like that, or will you still be in the position where 50% of your work, as was the case over the past 10 years, is associated with fee issues as such? If it is, we will not be able to move forward.

Natalie Ceeney: I am an optimist. I think we have to find ways of doing it, but part of it is power and part of it is culture. As to the things in the Bill that I think are good to prevent mis-selling, we need a regulator who will intervene earlier, which is partly to do with powers and culture. We need a mechanism whereby when systemic issues are flagged they have to be brought to the regulator's attention. Others have talked about a super complaint power, and under the present proposals that is mooted. We would welcome a formal mechanism for issues to be brought to the regulator's attention with a time limit for resolving those, but it really comes down to the will to act. We need a willingness to act.

Q206 Chairman: There is one final question that I hope each of you can answer in two sentences at most. Is there any single power or objective not in the Bill that you would like to see included, or anything in the Bill you would like to see changed? If the answer is no, that's fine.

Tony Hobman: No, other than perhaps some clarification, which may be consulted on, to take in our debt role. For the record, our precise budget is £43.7 million.

Natalie Ceeney: The super complaint issue I raised needs clarification. At the moment it is a very tentative issue, and it is quite material to the future of the Bill. Others have already mentioned debt and where that fits in. For the ombudsman it does not matter because we can work under multiple regulatory regimes, but to clarify that is key for other reasons.

Mark Neale: The Bill looks to be in good shape to us, but we are working with our colleagues in FOS and the FSA to look at the existing provisions on the exchange of information among the regulatory agencies to ensure they provide for the free flow of information.

Chairman: Thank you all very much indeed for your evidence today. It is very helpful to the Committee. You have given very clear and comprehensible answers to all of us. Thank you for that and for your prior advice.