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The City of London Law Society

Competition Law Committee

**RESPONSE TO: The Financial Conduct Authority
("FCA") 'Our Future Mission' Consultation**

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RESPONSE TO THE FCA'S CONSULTATION ON ITS 'FUTURE MISSION'

1 Introduction

1.1 This response is submitted by the Competition Law Committee of the City of London Law Society ("CLLS") in response to the FCA's consultation on 'Our Future Mission' (the "Consultation Paper"), published on 31 October 2016.

1.2 The CLLS represents approximately 15,000 City lawyers through individual and corporate membership, including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multijurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees.

1.3 The Competition Law Committee members who prepared this response were:

- Nicole Kar (Partner, Linklaters LLP) (Vice Chair CLLS Competition Law Committee); and
- Dorothy Livingston (Consultant, Herbert Smith Freehills LLP).

1.4 The CLLS welcomes the opportunity to respond to the Consultation Paper. The FCA, as a financial conduct regulator is unique in that it is conferred with an express competition objective and mandate. As the FCA continues to embed 'competition' with both internal and external stakeholders as part of its wider regulatory tools and functions, we have focused our comments with competition considerations in mind.

2 Response

2.1 Ensuring markets function well

2.1.1 **Q1: Do you think our definition of a well-functioning market is complete? What other characteristics do you think we should consider?**

As a financial conduct regulator, the FCA places significant emphasis on the structure of the market from the supply side. Whilst this is appropriate, where the profile and needs of consumers are ever more complex, it is also important to have due regard to demand side considerations which might affect an assessment of a well-functioning market. We note that this is a factor which the FCA has been taking into account in its market studies to date.

2.1.2 **Q2: Do you think our approach to consumer loss in well-functioning markets is appropriate?**

We agree the FCA's approach to consumer loss identifies key factors that drive consumer loss, but it is also important to acknowledge when developing policy, how these factors interact and change over time.

2.1.3 **Q3: Do you think we have got the balance right between individual due diligence and the regulator's role in enforcing market discipline?**

From a policy perspective, it is important that the FCA creates a market environment that provides the conditions in which effective competition can take place. The FCA rightly recognises that the role individuals play in seeking to enforce market discipline will not apply equally across all market sectors. Regulatory intervention should always aim to be proportionate.

2.1.4 Q4: Do you think the distinction we make between wholesale and retail markets is right? If not, can you tell us why and what other factors you believe we should consider?

We consider the categories to be consistent with distinctions made generally. Whilst delineation between retail, wholesale and capital markets based on common characteristics can provide clarity to market participants, it is also important to acknowledge these markets are dynamic and there is cross-over (for example, an SME may form part of the B2B market while equally being a 'consumer' in a retail market context). In addition, we wonder if sufficient weight has been placed in some previous market studies conducted by the FCA on the sophistication of clients in wholesale markets and suggest that appropriate flexibility be introduced.

2.1.5 Q5: Do you think the way we measure performance is meaningful? What other criteria do you think are central to measuring our effectiveness?

We agree that it is important to seek to monitor performance as part of being an effective regulator, both in terms of delivering value but also effective market outcomes. Many of these measures may be expected to be qualitative and in the form of policy changes, supervisory action, enforcement, enhanced levels of competition and through outcomes of market studies and thematic market reviews. Engagement with stakeholders and/or their representatives (for example, consumer bodies) affected by the outcomes of the FCA's work may also offer alternative qualitative measures. Quantitative measures, for example new firms entering a market could also be effective performance indicators.

2.2 Meeting the FCA's Objectives

2.2.1 Q6: Do you think the way we interpret our objective to protect and enhance the integrity of the UK financial system is appropriate? Are there other aspects you think we should include?

We consider that effective regulation is best achieved by creating a market environment where competition can take place on the merits, supported by resilient market infrastructure and consistently understood standards of market practice. In general, intervention should support competition rather than impose additional regulatory restrictions which as the FCA will appreciate can produce market distortions and act as barriers to entry/expansion. Regulation should strive to achieve the right balance between minimum standards (reflected in the FCA's rules) and principles which establish the framework within which firms can innovate and compete.

2.2.2 Q7: Do you think our intervention framework is the correct one?

We agree the FCA's intervention framework provides a structured approach to intervention and that it is right that the FCA has a number of different tools to give effect to any intervention. The tools deployed by the FCA should be proportionate to the cause and extent of potential harm identified. Intervention should not impose

undue administrative burdens on firms and other stakeholders alike. The choice of tool(s) deployed should be no more than is necessary to achieve the FCA's objective, consistent with the FCA cost-benefit analysis.

2.3 Regulation and broader public policy – getting the balance right

2.3.1 Q8: Where do you believe the boundary between broader policy and the FCA's regulatory responsibility lies?

We consider that the FCA's regulatory responsibility should primarily be focused on maintaining healthy and successful financial markets with clear, proportionate and consistent standards of market practice, transparency, open access and effective competition; and which is supported by robust market infrastructure. Healthy and successful financial markets will be dynamic and responsive to technology innovation and change. The FCA should encourage and promote innovation in financial services and its competition objective is an effective tool through which to facilitate this.

2.3.2 Q9: Is our understanding of the benefits and risk of price discrimination and cross subsidy correct? Is our approach to intervention the right one?

An analysis of the benefits and risks of price discrimination and cross-subsidies is a complex one and the impact of such practices will vary significantly depending on the market sector impacted, consumers affected and the different products and services involved. The FCA recognises the impact of these challenges in undertaking any such analysis. We consider that a case-by-case evidence based analysis of the potential harm and countervailing benefits is the most appropriate means by which to assess such a complex issue.

2.3.3 Q10: Does increased individual responsibility increase the need and scope for a greater and more innovative regulatory response?

Healthy and successful financial markets will be dynamic and responsive to technology innovation and change. The FCA needs to be responsive to both firms as they innovate through the development of new products/services and infrastructure; as well as consumers as they become ever more sophisticated and their requirements more complex. In promoting innovation in the interest of users, this may require the FCA to pursue 'non-traditional' regulatory responses.

2.3.4 Q11: Would a Duty of Care help ensure that financial markets function well?

We don't consider that an express Duty of Care is necessary and may represent over-intervention. The scope of products and services available to retail customers and the frequency with which these products and services change makes 'a reasonable duty of care' difficult to define. Financial markets function well when consumers are empowered to make effective choices about products and services which best meet their needs. The FCA competition objective provides a tool through which to create an environment in which effective competition may take place (for example, by implementing measures to reduce information asymmetries through enhanced transparency to retail customers). Where competition works effectively, a duty of care should not be necessary.

In addition, FCA principles impose an obligation to treat customers fairly and a requirement under COBS to act honestly, fairly and professionally in accordance

with the best interests of its client. These principles and rules impose obligations on firms and individuals in the way they act. The FCA also has powers to direct firms to provide redress to customers. Other sources of redress also exist outside of the FCA's regulatory perimeter that consumers are able to avail themselves of (for example, consumer protection legislation).

2.4 Protecting consumers

2.4.1 Q12: Is our approach to offering consumers greater protection for more complex products the right one?

We consider that such a distinction should be assessed against the profile of the customers concerned and their ability to make effective choices about the products and services they purchase, having regard to product governance. More complex products shouldn't necessarily require greater protection where product governance processes are effective in identifying the relevant target market and appropriate disclosures are made. There should be a balance between providing protection and intervention which prescribes firms' market conduct.

2.4.2 Q13: Is our regulatory distinction between consumers with greater and lesser capability appropriate?

We consider that such a distinction can be appropriate but this should also be balanced against the risk of making assumptions about which consumers have a greater or lesser ability to take decisions. Consumer capability will also be market sector specific, product and service specific and will change over time. These types of factors should be considered when seeking to make such distinctions.

2.4.3 Q14: Is our approach to redress schemes for issues outside our regulatory perimeter the right one? Would more specific criteria help firms and consumers?

The FCA's approach to redress schemes both inside and outside of its regulatory perimeter, in general, appears proportionate. Where the FCA undertakes a multi-faceted role in redress, firms and consumers alike could benefit from greater clarity from the FCA on the scope of and role it plays. This means setting clear expectations for firm conduct and the mechanisms of redress that will be pursued by the FCA. For consumers, it means providing clarity / education on the mechanisms available to them. One area, however, where improvement could be made is in relation to the rigour applied by the FCA when determining causation and loss issues in establishing redress schemes.

2.4.4 Q15: What more can we do to ensure consumers using redress schemes feel they are receiving the appropriate level of personal attention?

On an informal basis, consumer education and awareness campaigns for consumers on redress procedures could empower them to more effectively engage with those operating the redress scheme. On a more formal basis, it may include monitoring either directly or indirectly, through a skilled person, consumer satisfaction in so far as they consider redress has met their expectations.

2.5 Vulnerable consumers

2.5.1 Q16: Is our approach to giving vulnerable consumers greater levels of protection the right one?

As a financial conduct regulator, the FCA will be expected to intervene where there is a risk of substantial harm to particular consumer groups. We agree it is appropriate for the FCA to assess the potential harm of a particular product, firm or markets and the capabilities of consumers using them. However, there are diverse causes and effects of vulnerability and it is important that any intervention is proportionate to the harm identified and does not distort effective competition by prescribing market conduct for firms or otherwise imposing restrictive measures which dis-incentivises them from serving the market. Proposed interventions ought to also have regard to the position of the broader target customer group.

2.6 The role of disclosure in consumers' choices

2.6.1 Q17: Is our approach to the effectiveness of disclosure based on the right assumption?

We consider that disclosure and transparency requirements are effective measures which can assist consumers to apply market discipline. Where consumers take responsibility for their choices these measures are an efficient and cost effective means by which to improve the functioning of the relevant market, particularly in conjunction with product governance obligations imposed on firms. Where consumers do not respond to disclosure in the manner in which policymakers and regulators had intended, it should not be assumed that this arises as a result of a failure to correct for information asymmetry. As behavioural economics demonstrates, there may be any number of, often complex, factors which drive consumer choice.

2.6.2 Q18: Given the evidence, is it appropriate for us to take a more 'interventionist' approach where conventional disclosure steps prove ineffective?

The extent to which the FCA may take a more 'interventionist' approach where conventional disclosure steps prove ineffective should be considered on a case-by-case basis and having regard to wider product governance obligations imposed on firms. An interventionist approach assumes that disclosure will rarely be effective as a tool to enable consumers to make informed decisions and manage / mitigate risk. An interventionist approach may also result in unintended consequences. For example, imposing price constraints may assist consumers who make poor choices whilst hindering other more sophisticated consumers who do make 'good' choices. It also has the potential to stifle innovation in the market or disincentive participation if firms perceive such restrictions as hindering their ability to profitably serve the market or certain market segments.

2.7 When will the FCA intervene

2.7.1 Q19: Do you think our approach to deciding when to intervene will help make FCA decisions more predictable?

We consider having pre-defined, consistent and well communicated administrative priorities can provide for more predictable decisions, but note this can be difficult to implement consistently in practice given the decision to intervene will necessarily turn on the facts and circumstances of each case. Greater transparency may present an alternative means by which to provide greater predictability. The FCA is transparent at the formal end of remedies (for example, market study remedies,

enforcement and formal redress) but there is less information available regarding informal or early interventions. Greater publicity in respect of these issues could be beneficial.

2.7.2 Q20: Are there any other factors we ought to consider when deciding whether to intervene?

In addition to those identified, other potential considerations may include (at a macro level) whether the outcome of any intervention will assist to produce efficient and effective financial services markets. A more practical consideration may be whether there are potential impediments to remedies implementation in practice, such that the scope and means of intervention may be better achieved through one package of tools over another.

2.7.3 Q21: What more do you think we could do to improve our communication about our interventions?

As set out above, the FCA is transparent about the different types of interventions it undertakes but communication could be enhanced through taking a more active role in sharing lessons learned and what 'good' practice looks like, particularly in wholesale sectors markets. Risk will also differ for any one market affected.

2.8 Competition and market design

2.8.1 Q22: Is there anything else in addition to the points set out above that it would be helpful for us to communicate when consulting on new proposals?

Competition law enforcement under the Competition Act 1998 and the Treaty on the Functioning of the European Union is well understood by firms but they could benefit from greater clarity / education to firms about how the FCA's wider competition objective interacts with conduct regulation and how the FCA's objective impacts policy, regulation, supervision, authorisations and enforcement. For example, the Fair and Effective Markets Review is a good case study for where the FCA has highlighted how regulation and competition work together to achieve good market outcomes.

2.9 Supervising firms

2.9.1 Q23: Do you think it is our role to encourage innovation?

Financial markets are dynamic and the FCA must be responsive to innovation. Innovation fosters competition and where competition works well, it does so for consumers, firms and the market as a whole. This in turn will also foster greater market integrity. The FCA should continue to actively encourage innovation as has been illustrated through Project Innovate and the introduction of the Regulatory Sandbox initiatives.

2.9.2 Q24: Do you think our approach to firm failure is appropriate?

Orderly and functioning markets will see firm failure where they cannot meet the standards of consumers or regulators, particularly where markets are competitive. We consider allowing the orderly exit of a firm is consistent with the FCA's statutory objectives.

2.10 FCA's approach to enforcement

2.10.1 Q25: Do you think more formal discussions with firms about lessons learned will help improve regulatory outcomes?

Active engagement in sharing lessons learned and good practice allow expected standards of conduct, as well as the consequences of failure to comply, to be clearly understood.

2.10.2 Q26: Do you think that private warnings are consistent with our desire to be more transparent?

Although private warnings are issued on a confidential basis, they are consistent with the FCA's desire to be transparent. They provide clarity to firms about the type of conduct giving rises to concern / breaches, the standards of conducted expected on a forward looking basis and the consequences for failing to remediate any non-compliance. We also consider that undue focus should not be placed on the label of 'private warning'. A private warning ultimately reflects a decision that referral to enforcement or formal enforcement action was not judged necessary or proportionate in the circumstances but where the FCA nevertheless considers it appropriate to communicate its views as to the potential / actual failures and its expectations in relation to these. Where prioritisation principles are applied, not every case will result in public sanction, and the FCA should retain the flexibility to adjust the level of formality and /or detail it uses to communicate its views and expectations in scenarios where a public outcome is not considered an appropriate outcome.