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Financial Conduct Authority

Via Email: FCAMission@fca.org.uk

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Response to Consultation on the Future Mission of the FCA

Dear Sirs,

We are responding to the document published by the FCA entitled "Our Future Mission". As an organisation we represent the interests of private shareholders who directly hold shares in public companies as well as often holding many other kinds of financial investments so we have an interest in this matter.

Our answers to the detail questions posed in this consultation are given in the Appendix to this note and we will also post them in the on-line response forms. However, we have given a summary of some of the key points below.

In general we have been concerned for some time about the effectiveness and focus of the Financial Conduct Authority (FCA) and the consultation document tends to reinforce our view on that. It is a somewhat discursive document without a clear focus on the main issues that need to be faced in the future by the FCA, or its past failings. One might summarise the main concerns of our members about the operations of the FCA under these headings:

1. Not recognising that individual investors participate directly in capital markets, i.e. there is an artificial distinction drawn between wholesale and retail markets which does not and should not exist.

2. As a result of the above, not ensuring that individual investors are protected from financial market practices that have grown up which prejudices their interests - for example the now widespread use of nominee rights that destroys shareholder rights, the use of share "placings" that discriminate against private investors, the use of schemes of arrangements, the use of pre-pack administrations, and similar changes.

3. The encouragement of speculative trading practices such as the promotion of Contracts for Difference to retail investors who typically lose money on them in which the FCA has only recently taken an interest. In general the FCA has been too slow to respond to changes in market practices and too slow to stop abusive activities being promoted to retail investors.

4. The failure to ensure a level playing field between institutional investors and retail investors (no equivalent of the US Fair Disclosure Act for example) and the restriction of information provision to private investors.

5. The failure to vigorously and expeditiously investigate complaints about the activities of public companies and financial market participants, the failure to report the results of such investigations and the use of "private warnings" instead of public censures.

6. The failure to investigate possible breaches of the Financial Services and Markets Act (FSMA), but relying on investors to pursue civil legal actions which can be enormously expensive.

7. The general failure to ensure fair, honest and well functioning markets. This is a particular problem in the shares of smaller companies such as those listed on AIM.

Now some of the above issues may be related to the resources available to the FCA, but if that is the cause then the FCA's mission statement should be focussed on what is achievable within the financial resources that can be obtained.

Our detailed responses to the questions posed by the FCA are given below, and will explain our reasons for the above comments.

We would welcome a meeting with FCA management to discuss these matters.

Yours sincerely

Roger W. Lawson
Deputy Chairman

Appendix
FCA Mission
List of questions - And Answers

See https://www.fca.org.uk/publication/corporate/our-future-mission.pdf for the full consultation document.

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

Answer: It would be easier to answer this question if the "Our Future Mission" document clearly defined what the FCA currently considers to be a "well-functioning market".

Our suggested definition would be that a well-functioning market is one where buyers and sellers can transact in a fair and honest environment, where there are willing buyers and willing sellers, and where information provided by both parties is accurate and is in the public domain, i.e. that one side has no great advantage because of private or concealed information, or "information asymmetries" as the document defines it on page 13.

Markets also need to be "orderly" which does not appear to be mentioned at all as an objective for the FCA. In other words, financial markets should be fair, reliable, secure and efficient. Orderly markets usually have stable and competitive prices with reasonable liquidity, reflecting the true value of the good or service. In a disorderly market, there may be market manipulation, insider trading and other abuses. investors may lack the confidence to participate in disorderly markets.

The document suggests that there is a distinction between wholesale and retail markets (see page 13 and on page 12 where it suggests retail investors are not the main participants in capital markets). We can see no reason for such differentiation or difference in regulatory approach. Many retail investors participate directly in the market for publicly listed shares or bonds but have been prejudiced in the past by the lack of recognition of that fact by the FCA or its predecessors. The extent of the direct participation of retail investors in the stock market (as opposed to via funds or pension schemes) is documented on this page of the ShareSoc web site: http://www.sharesoc.org/market_statistics.html . For example it's about 12% and rising in terms of the value of shares held, and could be as high as 65% in terms of transaction volumes.

The FCA document does suggest that market regulation can ensure an appropriate minimum quality standard. This is particularly necessary where the quality of the products being sold may not be immediately apparent (for example in food standards) or where significant damage may be caused by defective products. Financial products are often exceedingly complex and their attributes may not be apparent to many of the purchasers so it is certainly necessary that minimum standards should be enforced.

We recognise that there is inevitable uncertainty in the outcomes of some financial transactions, and not every loss to investors can be prevented. One cannot always protect fools from their own folly. But at present the overall effectiveness of regulation is poor because the regulators are regularly outwitted by clever financial operators in such matters as the design of new products. There is also insufficient emphasis on the oversight of financial market operators, insufficient weight put on always acting in the best interest of clients (a "fiduciary duty"), and in basic honesty and fairness in financial markets, i.e. moral principles seem to have been abandoned in many cases.

We do not consider that all financial markets currently function well. For example the AIM share market has been heavily criticised by ShareSoc and others for the numerous failures of companies listed thereon, often caused by false accounting, inadequate information disclosure and other dubious activities including market abuse - the FCA may not be the listing authority for that market but it has responsibilities for other aspects.

In general we consider the regulatory activities of the FCA are not currently active enough and not properly resourced to ensure that markets are well-functioning. Retail investors cannot rely on the current level of regulation to ensure that they will not be duped or lose money as a result of failings by financial advisors or other market operators beyond their control.

The recent initiative by the FCA to clamp down on some aspects of the sales of Contracts for Difference (CFDs) is an example of a slow response to a widely known problem - namely the encouragement of short term speculation using products which were likely to lose most investors money with an associated failure to disclose the inherent risks.

Another example of a failure to prevent market abuse is the recent prevalence of "shorting attacks" by organisations or individuals typically based overseas where they publish negative allegations about a company on the internet at the same time as shorting the stock but the company cannot take any action under UK libel laws.

Even if they could, the share price collapses in the short term, causing losses to investors while the shorters profit. A recent example was that of Paysafe, a FTSE-250 company attacked by Spotlight Research. It is impossible for us to comment on the accuracy of their "research", but as the company denied it was true, then clearly either Spotlight or Paysafe are potentially guilty of market abuse. Is the FCA investigating this or other similar cases? We doubt it.

The internet and the rapid distribution of information, sometimes false, has given rise to many new abuses which the FCA seems to have done little to control. Apart from shorting attacks, there have been many apparent cases of "ramping", some of which have been brought to the attention of the FCA. But there seems to be a reluctance to ensure an "orderly" and "honest" market as we spelled out above.

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

Answer: The published document provides a discursive commentary on this issue but does not clearly define what the approach to consumer loss should be. As mentioned above, we accept that not all losses can be prevented. However, there needs to be a clear definition of when the FCA considers it is necessary to pursue action against the causes of such losses (e.g. failures by individuals or organisations) and when compensation may be applicable.

For example, the FCA seems to take very little interest in some matters - for example, the failure of smaller public companies, the abuse of pre-pack administrations, the failure to take an interest in misleading prospectuses (e.g. those issued by Lloyds-TSB and the Royal Bank of Scotland), the undermining of shareholder rights by the use of the nominee system, corporate restructurings and schemes of arrangement, permitting rights issues to be abandoned in favour of placings which benefit a few "city insiders" etc. We could go on at great length on this topic, but it is certainly not clear at present as to when the FCA will consider a matter or give it any priority. Perhaps this is a resource related issue, but if so it should be clearly spelled out what principles are to be followed to decide on the allocation of resources. This document does not define that.

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

Answer: The document does not clearly define what the balance should be, but we suggest that relying on individual due diligence only works if the information presented to the individual is clear and unambiguous and is actually communicated to them. Examples of where this was not the case were the sales of PIBS by the West Bromwich Building Society promoted as "fixed interest bonds" when the small print said otherwise and where many retail investors, and their advisors, never seemed to have seen the small print or did not understand it. Likewise the Lloyds ECNs where the expectations of investors were confounded and even the company did not seem to have legal clarity on how they were expected to operate, but then decided in their own favour and subsequently defended their legal stance without the FCA intervening.

There should be a general rule imposed as a matter of principle that no investor should be prejudiced where the terms of any contract are not disclosed in a fair and clear manner (i.e. an "unfair contract term" provision).

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?

Answer: As already pointed out, we see no reason to draw a distinction between wholesale and retail markets. Sophisticated individual investors often participate in what might be viewed as wholesale markets, or less sophisticated investors are advised to participate by financial advisors. The latter was one of the causes of the damage to many retail investors which resulted from their participation in the Lloyds Insurance market as "Names". Incidentally institutional investors are often damaged by the same problems as affect retail investors, and do not always have the financial and legal resources, or the inclination, to pursue matters.

We are concerned that treating retail investors as different to institutional investors, i.e. considering them "unsophisticated", leads to their prejudice. For example, exclusion from fund raisings, inability to receive information from brokers and advisors and generally the introduction of an un-level playing field for financial services. Unlike the USA, where the Regulation FD (Fair Disclosure) ensures that there is no prejudice between any groups of investors, the City of London still seems to operate on the principle of closed, "insider" networks which the FCA does little to stop.

The latest example of muddled thinking in this area is the proposal to classify some Local Authority Pension Funds as "retail investors" (i.e. "unsophisticated investors) no doubt because of their past incompetence in investment management. This might damage their ability to invest in certain vehicles such as infrastructure funds, to their detriment.

These kind of "broad brush" approaches to the classification of investors and hence their ability to operate without expensive advice does not reflect the reality of the various backgrounds of retail investors.

The failure to recognise that retail investors participate in wholesale financial markets has led to a number of prejudicial developments in the UK stock market against which the FCA has not intervened. That includes:

- Allowing the nominee system to erode individual shareholder rights so that private shareholders have little influence over company directors and their actions.

- Permitting dilutive "placings" as opposed to rights issues, which destroys the principle that all shareholders should be treated equally and that pre-emption rights are important to protect the interest of investors. Discounted placings, with no associated open offer, transfers value from those who cannot participate (typically retail investors), to those who can.

- Restructurings and schemes of arrangement not being effectively regulated. Schemes of arrangement can enable take-overs to be done without a majority of shareholders voting in favour, and the failure to enfranchise nominee shareholders properly supports this approach to the prejudice of private shareholders.

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

Answer: There is no clear definition of how the performance of the FCA is measured in the document. This is a very large omission as one of the big complaints about the FCA is its lack of effectiveness in dealing with complaints. There is no statistical data provided so far as we are aware on "customer satisfaction" with the resolution of complaints to the FCA, the time to deal with complaints, the number that result on any enforcement action, etc. In far too many cases, complaints are made and the complainant never hears anything more for months or years, if at all. The FCA simply appears not to want to be accountable to the people it serves.

Note: The question numbers in the body of the document do not match those at the back of it or to the online response form - see questions 6 and 7 which are reversed in sequence. The numbering below refers to that at the back of the document.

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?

Answer: It is not at all clear from the document how the "Objective" is defined at present and how it is being interpreted. There is a discussion on "operational objectives" but this mixes principles with more practical matters. We suggest there should be a clearer definition of policy objectives.

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

Answer: No comment.

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

Answer: The boundary certainly needs to be defined more clearly than at present. It is not at all clear at present why some activities fall out of the scope of regulation while other similar activities fall within (and organisations may be providing both and linking them).

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

Answer: Pages 22 and 23 of the document deal with the social exclusion in financial services and market segmentation used by financial services companies to maximise profits. We see the former as a matter of public policy and am not clear why that should be part of any mission statement by the FCA other than where mandated by specific Government imposed laws or specific regulations.

As regards market segmentation, there are obviously some consumers who will pay more than others for the same service, or slightly different one with no difference in cost provision. We see no "unfairness" in that so long as information is readily available on the supply of alternatives, and hence no general need for the FCA to interfere.

As regards new services, often prompted by new technological innovations, we suggest the FCA should review such services as and when they appear so as to ensure that they are in accordance with the principles mentioned above, i.e. that what is being provided and the risks associated with them are made clear.

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

Answer: There is certainly a potential, if not actual, problem with the increased reliance on individual responsibility - for example in the ability for people to cash in their pension fund, and invest it more directly. This is already leading to plenty of abuses where unsophisticated people are sold inappropriate investments simply because of their lack of education and experience in such matters. We agree that the regulation of this area needs further consideration and possibly new approaches used to stop abuses. A clear fiduciary duty on intermediaries would assist of course (see answer to next question).

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

Answer: We believe that a "Duty of Care" should be an obligation on all those involved in the provision of financial services and we would go further and suggest that there should be a specific "fiduciary duty" to act in the best interests of clients (as opposed to the interests of the product/service providers). In addition these responsibilities should be capable of being enforced in civil legal actions.

At present the financial services industry tends to be run in the interests of the industry rather than the consumers of the services. As a result, many retail investors (and consumers) are prejudiced and cannot obtain redress when required even when a breach of the duty of care, or for example, a breach of the FSMA or associated regulations is apparent and results in a declaration by the FCA. When such complaints are upheld, investors who have suffered as a results should not need to take civil action, which is now prohibitively expensive for all the but largest organisations, in order to receive compensation.

Incidental to this question is whether the FCA should continue to have immunity from civil actions under the Financial Services and Markets Act (FSMA) 2000. For example the failure to adequately regulate banks before the 2008 financial crisis was one cause of massive losses by investors. Regulation would clearly be improved if the FCA had an enforceable legal obligation to act competently and within reasonable timescales. At present even outright negligence by the FCA is not actionable.

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

Answer: In general this is difficult to argue against, but the problem surely is the definition of what is a "complex" product. For example, it was initially suggested under MIFID 11 that all investment trusts would be defined as "complex" products and hence their availability to investors would be restricted based on their sophistication or whether advice was being provided. This was despite the fact that investment trusts are long established in the UK and are not much different to unit trusts or OEICs. This seemed a perverse outcome. Or for a simpler example perhaps, are direct investments by consumers in individual stock market listed companies on an execution-only basis to be seen as "complex" and requiring more regulation and restriction? We would be very opposed to that despite the fact that understanding individual companies and their financial profile and associated risks can be difficult.

It is not so much the "complexity" that matters, but how much information is available on the products and their past track records (investment trusts and individual stock market companies have enormous volumes of historic data available), plus how familiar the investors are with such products. That danger arises when new products are invented (for example crowd equity or loan funding, as recently), of which the market and consumers have little experience. Particular emphasis must therefore be placed on other factors than "complexity" alone.

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

Answer: There are clearly large differences in the range of knowledge and experience of individual consumers. But an investor may be very knowledgeable and experienced in one financial market sector, but not in others. To use a "broad-brush" approach to classify consumers or individual investors is therefore fraught with danger. We believe it would be wrong to determine regulatory activity based on such presumptions, although if it becomes apparent that particular classes of consumers are being targeted for dubious propositions then that should prompt some action.

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

Answer: There are a number of problems at present in this area - for example the scope of "Consumer Redress" schemes under FSMA can prejudice many complainants.

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

Answer: Improved communication from the FCA to complainants would assist, including reporting on the status of investigations where appropriate. This is a wider problem when dealing with the FCA, not just about redress schemes.

It is odd that a complaint to the police about an alleged crime does not stop the police from advising you on the status of an investigation (unless it prejudices it by doing so). In the case of the FCA, they tell you nothing and give you no indication whatsoever that any action is being taken. This is deeply unsatisfactory. Even when a complaint is rejected you may not be told the reason why, or told anything at all. Where a complaint is upheld, you may not be informed of any enforcement action and it may not be made public. This is unreasonable and unacceptable as it is not fair as between consumers and financial institutions. The former should know about the dubious activities of the latter so they can avoid them.

The time it takes for the FCA to investigate complaints also prejudices a satisfactory outcome for many complainants - they can often die before complaints are resolved!

The recent example of the collapse of the Connaught Series 1 Property Fund shows how slow responses by the FSA (the FCA's predecessor) to information received can seriously prejudice investors. Or another recent example was the difficulties faced by open-ended property funds last year arising from minor changes in asset values when investors headed for the exit door. With illiquid assets in the funds, they had to close to redemptions. Should such funds have ever been permitted when they were known to be vulnerable to such risks? A much more vigorous and active approach is surely required, i.e. a "proactive" approach to regulation rather than the existing "reactive" one which often results in closing the stable door after the horse has bolted.

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

Answer: We are not sure that this approach to vulnerable consumers make sense. For example, in the sales of "payday loans" would they be ok if sold to sophisticated consumers, but not to the financially illiterate? This seems to be very muddled thinking. If products are morally dubious (e.g. usury in nature), then they should surely be targets for regulation whoever they are sold to.

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

Answer: What is said in the document on disclosure is accurate. It can often be ignored by consumers. But the document does not clarify when the FCA considers intervention appropriate. There surely needs to be some moral principles introduced here: for example is the disclosure providing all the facts in an unbiased way, or is it designed to deceive?

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

Answer: Yes.

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

Answer: It is not really clear from the document what the current approach or proposed one actually is.

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

Answer: The lack of consideration of the number of people affected, or the size of the financial damage caused to individuals does not seem to be included in the factors.

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

Answer: As already indicated in our response to question 15, we believe the FCA is currently very poor in communicating in response to specific complaints. In addition where it is tackling wider policy issues or market interventions, it rarely consults properly. That is particularly so with respect to retail investors or consumers (the document we are commenting on is a good example of how to deter responses from a lack of clarity about what it is really about - it seems to be more a chain of thought than a set of specific proposals, and the questions are not well focussed).

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?

Answer: See answer to previous question.

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

Answer: We would prefer the FCA to focus on improving its existing regulatory activities rather than move into this area. There is plenty of innovation in the financial sector without the FCA getting involved directly other than keeping an eye on what is developing.

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

Answer: No comment.

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

Answer: Yes.

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

Answer: No they are not. All warnings to firms should be made public, and publicised. This would focus the minds of the directors of such firms in avoiding public censure and help prevent such events arising. And justice must be seen to be done.