

The future direction of regulation – risk or reward?

October 2024

Introduction

Recently Disney attempted to block a lawsuit from a man whose wife died last year after a severe allergic reaction at a restaurant in Disney World, because of terms he signed up to in a free trial of Disney+ four years prior. Following significant media attention and public backlash, Disney withdrew its objections to the lawsuit. The application of a common-sense approach to customers and their rights is the same judgement that the FCA intends for firms when applying the Consumer Duty, albeit in happier circumstances.

Competition vs consumer protection

Both the FCA and the new government have recently signalled a desire to prioritise growth in the UK financial services industry and to promote competition. In part, this might be achieved through more principles-based regulation such as the Consumer Duty.

This summer the FCA announced that it would seek to “reduce burdens on firms and support growth” using the opportunity of the Duty and the move to an outcomes-based approach to streamline its rulebook. A willingness to streamline detailed rules is likely to be welcomed by many firms - but is not without risks when it comes to interpretation and application.

The tension between securing consumer protection and promoting a healthy market is a balancing act which has always existed for the regulator. On a micro level, we have seen it play out in the Skilled Person Reviews which we conduct here at Pathlight. There’s always a consideration as to how far an intervention should go when balancing the risk of harm to consumers, versus unnecessarily damaging a viable firm if the rules are interpreted too stringently. Proportionality is a watch word for Skilled Persons as well as regulators – and it should be for firms.

What are the implications of the new ‘growth’ agenda?

The regulator has been fairly stringent in its demands over the last five years at firm supervision level around controls, and the timeline for embedding these into practice. Emphasising growth and competition, even as secondary objectives, may result in a reduction in the time required by the regulators for newly enhanced controls to be embedded, for example 3 to 6 months, rather than 6 to 12 months.

In addition, the principles-based approach of the Consumer Duty might point the way in other areas traditionally heavy on prescriptive application, such as Client Assets (CASS) Rules. In applying CASS, we have seen very specific rules - such as the need to delete square brackets that denote where text is to be added to a template document - resulting in the regulator instructing firms to reissue and re-execute the documents, at significant cost and effort.



So, the new focus on growth and principles-based regulation could lead to a reduction in cost for firms, and in extreme cases avoiding insolvencies. It will however also lead to greater uncertainty around interpretation of the rules.

Interpretation will require a higher level of skill and experience from both firms and the regulator to form judgement calls around principles-based regulation. We've seen high staff turnover at both firms and the FCA over the past few years, which risks inexperience and inconsistency when it comes to making these calls. As the new direction becomes embedded, it will be important for the regulator and regulated firms to have experienced personnel in key roles.

What should firms do?

Train and upskill both staff and board members to be able to apply more principles-based regulation. Staff should be made aware that they are doing more than simply following a set of rules, but rather thinking through the intention behind the regulation.

There will also be a greater requirement from Non-Executive Directors (NEDs) to raise challenging questions at board meetings around achieving regulatory purpose, rather than simply tracking Key Performance Indications or Key Risk Indicators. The board should also be able to challenge management information they receive along these lines. NEDs can also bring invaluable experience of how other firms are interpreting principles. While a “me too” approach is not helpful, an understanding of the range of peer interpretations is valuable input.

As a Skilled Person firm, we see a lot of small firms without independent NEDs (iNEDs) on the board. While costs can be an issue (sometimes more perception than market tested reality), an iNED can help avoid many regulatory missteps.

Ultimately, the new direction from the regulator enabled by the government's pro-growth and competitiveness agenda should create opportunity for financial services firms, but it will also require a more nuanced and enquiring mindset around the application and intention of regulatory requirements.