“Treasury Select Committee’s Inquiry on the Future of Financial Services”

Submission by the Transparency Task Force, February 19th 2021

Contents

Short Summary

We are calling for widespread transformation of the regulatory framework to deal with the many fundamental flaws that are inhibiting effective regulation, including but not limited to:

- A general lack of transparency
- A general lack of scrutiny
- A general lack of accountability
- A general lack of pro-consumer representation
- Under-utilisation of powers that have been granted by parliament
- Inadequate enforcement
- General failure to harness the power of deterrent
- Failure to apply the Senior Managers Certification Regime to good effect
- Conflicts of interest
- The "revolving door" problem
- The risk of regulatory capture

Introduction

About the Transparency Task Force; a Certified Social Enterprise.

The mission of the Transparency Task Force is to promote ongoing reform of the financial sector, so that it serves society better. Our vision is to build a highly respected international, influential institution that helps to ensure consumers are treated fairly by the financial sector. The primary beneficiaries of our work will be consumers; but the sector itself will also benefit through improved market conduct and increased trust in the services it provides.

Our objective is to carry out a broad range of activities that help to drive positive, progressive and purposeful finance reform, such as:

- Building a collaborative, campaigning community; the larger it is the more influence it can have in driving the change that is needed
- Raising awareness of issues; so that society better understands the problems that exist in the financial sector and how they can be dealt with
- Engaging with people who can make change happen; because through such dialogue we can influence thinking, policy making and market conduct

We are busy developing a framework for finance reform which we describe as a "whole system solution for a whole-system problem" as described in our book. We believe that there is merit in being constructively critical of financial regulators, where it is clear the evidence shows scope for improvement and where we are able to offer sensible solutions to the problems we identify. For further information about the Transparency Task Force see here.

All queries in the first instance to andy.agathangelou@transparencytaskforce.org please.

Our Approach to this Inquiry Response

This document has been produced by a group of Transparency Task Force volunteers working collaboratively. Our motivation is to help improve the effectiveness of the UK's Financial Services regulatory framework and thereby help to improve consumer protections.

We have chosen to focus mostly on the key issues relating to the investment market and in particular to the risk of consumers suffering serious detriment as a consequence of becoming a victim of an investment scam.

We believe that the best way to tackle poor conduct is to prevent it happening in the first place - prevention is better than cure.

Our input is not meant as a detailed "instruction manual" on what needs fixing and how to go about it. Rather, it sets out what we believe to be the key discussion points that warrant further investigation. We therefore hope our response may help to initiate further dialogue amongst all relevant stakeholders including of course the many victims of scams and frauds who have suffered at least in part as a result of regulatory failure; plus the many campaign organisations that represent their interests.

The TTF is a critical friend

As you will read, we are constructively critical of the present situation. We believe there is a woeful lack of proactivity by the regulators in tackling the causes of consumer detriment; and an equally woeful lack of effective enforcement.

We hope that HM Treasury and all relevant regulatory entities can adopt a "progress begins with realism" mindset i.e. a willingness to absorb and make good use of constructive criticism as a basis for making improvements. We make this point as we believe that our Regulators often seem rather defensive when being given feedback and may have a predisposition to ignore warnings of their failings. Our constructive criticism is well-intended; and we hope that it might be valued for what it is - a blend of creative, thoughtful input and honest feedback.

It would be good if financial regulators were to think of the Transparency Task Force as a "critical friend."

More than just a written response

The issue of ineffective regulation has become a major topic of interest within our community. We see poor regulation as "part of the problem" and have been putting a considerable amount of effort into understanding the root causes of the issues and what can be done about them.

We have run several symposia on related topics and we are pleased to provide access to the video recording of recent events run on matters relating to the topic of regulatory failure and the changes that would need to be made to create a more effective regulatory framework:

- "Optimising the Regulatory Approach to Financial Promotions" held October 14th 2020 - watch here.
- "About the FCA's Consumer Investment Markets Consultation" held November 11th 2020 - watch here.
- "Are the UK's Financial Regulators Failing?" held December 15th 2020, watch here.
- "Are the Financial Regulators Fit for Purpose?" held January 28th 2021 - watch here.
- "Fraud and the Fight to Fix it - reflections from a retiring Police Crime Commissioner, and others" held February 18th 2021 - watch here.

The need to expand the scope of our response

We feel the specific questions raised are unnecessarily narrow and we believe that if we were just to respond to those specific questions HM Treasury would miss the opportunity to receive what we believe to be the worthwhile additional insights and input that directly relate to the overall regulatory reform agenda as set out in the consultation.

We have therefore decided to provide our response in 3 parts:

Part 1: General observations and suggestions (this may be taken as our short summary, as required by the Terms of Reference for this inquiry).

Part 2: Our response to the specific consultation questions.

Part 3: Appendices covering other important and relevant issues

Part 1: General observations and suggestions

1. Prevention is better than cure

One of the challenges to any financial regulator is making effective use of its limited resources. We believe that the more effective regulators are at preventing scams, fraud, malpractice, malfeasance, misconduct and mis-selling, the more resources will be available to do everything else that it needs to do. Unfortunately, what we see today looks like a situation that is close to being out of control - regulators and enforcement agencies seem to be swamped.

Many commentators including regulator officials at Select Committee hearings seem to be admitting that they cannot cope. This has led to some debate around whether the public should expect to be protected.

We believe that had the regulatory framework including the enforcement of regulation been more effective in years gone by, the problem we have today would not be nearly so bad; and we believe that the regulators have a duty to do all they can to protect consumers from harm.

The issue is not whether the regulators have been given an impossible task; they haven't.

The issue is about reforming the regulators so they can do what they were created to do - to regulate our financial system. We believe that the regulators have failed to act swiftly and robustly in many areas, including prevention, enforcement, and, very importantly, creating an *expectation* that scammers and fraudsters will be investigated and prosecuted. The net result is that there is very little deterrence in our system, which goes a very long way to explain the rampant levels of economic crime that we now have.

Protecting the public from scams and not-as-advertised financial products

The desire to do much more to prevent criminal and unprofessional behaviour causes us to consider the importance of having an effective Financial Promotions Regime (FPR) because a robustly policed and enforced FPR would provide an efficient and effective gateway control to prevent scams. Action after the event is also needed to create a credible deterrent but by then consumer harm has been done; prevention is better than cure.

Furthermore, it isn't just outright scamming that needs to be tackled. It is vital that consumers are also protected from financial promotions that do not authentically describe the reality of the products they are promoting. One of many examples would be the financial promotion surrounding the Woodford saga; it is crystal clear that investors were buying into an investment fund that was not as described, with extensive consumer detriment as a direct result.

However, fundamental flaws with the current FPR and its enforcement have left the gateway open to those that mislead, intentionally or otherwise as well as fraudsters. The key is to ensure that Promotions clearly and straight-forwardly set out the investment proposition, the deal structure and relevant risk factors of the investment that they describe.

These flaws are a major factor behind the current epidemic of consumer harms impacting savings, investment and pension funds. Some cases are small; others very large indeed.

Regulatory background to the Financial Promotions Regime

The current Financial Promotions Regime requires financial promotions issued by unauthorised firms to be approved by a Financial Conduct Authority authorised firm subject to a number of exemptions.

Financial promotions are restricted under Section 21 of the Financial Services and Markets Act 2000, pursuant to which a person must not, in the course of business, communicate an invitation or inducement to engage in investment activity unless the promotion has been made or approved by an authorised person or it is exempt. Unauthorised firms often use authorised firms which are authorised to carry on a regulated financial services activity to approve their Promotions in order to comply with the Act and the regulations under it.

Although authorised firms are required to keep a register of promotions that they approve, the FCA does not meaningfully supervise this activity. Without meaningful supervision and enforcement the present regime does not protect investors, enabling unscrupulous promoters of investment products and services to take advantage of consumers.

Authorised firms are not required to notify the FCA once they have approved an unauthorised firm’s Promotion, nor does the FCA sign off on approved Promotions before they are communicated to consumers. As such, the FCA is only made aware of potential breaches of the relevant regulations.

Noting that the FPR is just one of many areas where the regulatory framework is failing badly, we now consider the key issues:

1. Issues with the existing Financial Promotions Regime

Regulation Issues:

I. There is no specific permission FCA authorised firms are required to have before they can approve a financial promotion.
II. There are no qualification or competency requirements for firms approving financial promotions.
III. There is no requirement to register or process for registering investments for which financial promotions have been approved. Hence neither the FCA nor consumers have access to records of investments where the promotions have been approved.
IV. Authorised firms and unauthorised firms with a FCA authorised group company are able to issue financial promotions without independent approval is a significant cause of consumer harm. Examples being London Capital & Finance , Basset & Gold and now GPG.
V. There is no clear set of requirements that an approving firm is required to apply to the approval exercise. For example there is no clear requirement that a Promotion must clearly and straight-forwardly set out the investment proposition, the deal structure and relevant risk factors taking into account the intended target audience.

Transparency issues:

I. Consumers cannot establish whether a promotion genuinely has been approved.
II. Consumers cannot establish whether approval of a financial promotion has since been withdrawn. This is a particular problem in practice with investment scams and frauds whereby a rogue FCA authorised firm approves a promotion then immediately withdraws approval.
III. Consumers often believe that approval of an information memorandum for an investment by a FCA authorised firm means that the investment itself is regulated by the FCA. Sometimes the firm may be regulated but the product might not be; there have also been instances of products that have been regulated but the FCA has *ex post* claimed otherwise. Connaught is an example of the former, LCF the latter.
IV. There is no reliable way for consumers to establish whether a firm offering its own securities is carrying out a regulated activity. Scammers thrive on this
V. There is no reliable, independent or efficient means for publishers of adverts (including online platforms) which are financial promotions to verify whether a promotion has been genuinely approved by an FCA authorised firm.
VI. There is no reliable, independent or efficient means for pension trustees, ISA managers, banks, building societies to verify whether a product subject to a client transfer has been lawfully promoted.

VII. There is no reliable way for consumers to establish whether or not the claims made in the promotion are valid, consistent and reasonable. Promoters may, for example, make unreasonable and/or inconsistent claims regarding return expectations.

VIII. There is no independent risk assessment of the promoted product/service to enable a consumer to assess the risk of the product/service either in isolation or within a portfolio context.

IX. There is no standardised framework/benchmark for measurement of the promoted product/service risk/return attributes.

X. There is no requirement for any cited risk, return, nor other characteristic to be clearly contextualised, to enable the consumer to evaluate the conditions and assumptions under which the characteristic expectations were formed. For example, expectations cited by the promotion may only be valid under a particular set of restrictive conditions.

Exemption Issues:

i. Online platforms operating from EEA states outside of the UK which qualify as providers of an *information society service*s such as Google Ads and Facebook are currently exempt from UK regulations relating to financial promotions. As a result of the exemption contained in Article 20B of the FPOthe online advertising platforms are not liable for the content to the adverts they charge to publish and so take no responsibility or effective action to vet advertisers and adverts. This issue is evidenced by the following from a 31 Jan 2020 email from FCA Chief Executive Andrew Bailey to Mark Taber:

> *Our analysis is that search results generated by Google and, in particular, paid adverts may constitute financial promotions. Google is likely to be 'communicating' such financial promotions for the purposes of the restriction in section 21 of FSMA. Google is not authorised by the FCA. So any financial promotions communicated by Google must be approved for the purposes of section 21 unless one or more exemptions in the FPO apply to their communication. On the basis that it provides an information society service, for the purposes of the EU E-Commerce Directive, from an EEA state outside the UK, it appears to us that Google generally benefits from the exemption in Article 20B of the FPO for incoming electronic commerce communications.*

ii. Unauthorised firms are able to issue unapproved financial promotions to consumers classified as HNW / Sophisticated. This exemption is being abused beyond belief by unregulated introducers and the boiler rooms they work with. They hide it in the small print, make the sale verbally then get a signature at the last-minute glossing over it as an inconsequential bit of paperwork. Also, many vulnerable consumers also happen to qualify as HNW and are being targeted using 'sucker lists' or via fake comparison sites. For example, elderly with dementia /

isolated, recently bereaved with inheritance, people with dyslexia, people disabled by accident with compensation.

The HNW exemption is widely abused, and even when it isn't, it's no excuse. In the Connaught case, the FCA used the HNW exemption as a defence. Harmed investors argued that sophisticated, professional and high net worth individuals also have a right to be protected from fraud by the statutory regulator.

We conclude that the HNW exemption is so widely abused that it should be abolished, which we believe will require a change to legislation. Furthermore, we are pleased to note that the FCA may already be considering such a move. We base this comment on https://www.fca.org.uk/publication/call-for-input/consumer-investments-market.pdf, paragraph 4.11 onwards, which would seem to confirm that our recommendation is not outside the Overton window.

We also wish to take this opportunity to note that it is all the more worrying that the recently introduced Financial Services Bill aims to make it easier to market investment funds into the UK:

> "This measure [5] will introduce new equivalence regimes for retail investment funds and money market funds, which will simplify the process for investment funds that are domiciled overseas to market to UK consumers".

Whilst we recognise that there is also a measure to make it easier for the FCA to remove authorisation, we are not convinced the FCA would make good use of such a power; we base this comment on the general perception we have that the FCA under-utilises its powers - a very good example being the poor use of its powers under the Senior Managers Certification Regime.

It is therefore vital that the new Financial Services Bill is used effectively and that any new consumer-protection legislation that is required is passed through it - there probably won't be another opportunity as good as this for years.

Enforcement issues:

i. Without effective enforcement even the best drafted regulatory regime is of no value in achieving investor protection

Without effective enforcement even the best drafted regulatory regime is of no value in achieving investor protection. The absence of enforcement by the FCA against firms who approve Financial Promotions means that whatever the law says it will be broken unless law breakers are prosecuted.

It is a criminal offence for an unauthorised person to issue a financial promotion which has not been approved under s21 of FSMA by an FCA authorised firm. However, the FCA's annual enforcement reports reveal that no financial promotions cases were opened or closed in 2017/18 and just 3 were opened with none closed in 2018/19. *Senior sources at the FCA are saying privately that there is a legal problem preventing them from prosecuting financial promotions offences*. This was reported by The Times 19 September 2020:

> *Young people lose thousands in trading 'scam' promoted by Instagram influencers*
>
> *The Times understands that part of the reason for the inaction is a stand-off between the FCA and the Treasury.*
>
> *A source familiar with the situation said: "The FCA say privately they have a problem enforcing these laws but the Treasury say they have given the FCA strong powers to deal with this so we are at an impasse."*
>
> https://www.thetimes.co.uk/article/young-people-lose-thousands-in-social-media-trading-scam-tjw0xrldb

Hence there is no credible deterrent to prevent abuse; which means the FCA is failing to harness the fear of enforcement and thereby failing to apply the inherently resource-efficient fear of prosecution. We make this point about resource efficiency because despite the FCA being perhaps the best resourced financial regulator in the world, a lack of resource is sometimes cited as an explanation for its ineffectiveness. We must conclude therefore that If the FCA wants to be more effective it should enforce tenaciously.

ii. The FCA does not take enforcement action against firms which approve false or fraudulent financial promotions. The FCA's response to a recent Freedom of Information request from Mark Bishop stated:

> *We have not prosecuted any authorised firms or individuals connected to them for approving the communication of misleading or inaccurate financial promotions.*

The Times: 28 July 2020 - Financial Conduct Authority criticised for failure to act over misleading promotions

> *The [Financial Conduct Authority] did not prosecute any authorised firm or individual over errant financial promotions between 2013 and 2019 and fined only three groups of authorised firms and individuals, according to a freedom of information request.*
> *The regulator also said it did not remove any authorised firm's regulatory permissions for approving a misleading or inaccurate promotion.*
>
> https://www.thetimes.co.uk/article/financial-conduct-authority-criticised-for-failure-to-act-over-misleading-promotions-x8sfj5wbl

Hence the current Financial Promotions Regime is archaic, opaque, not fit for purpose and open to abuse in order to facilitate scams and fraud.

It is, in effect, an invitation to scammers around the world to set up trade to prey on the UK's pensions, saving and investment market and it helps explain the pandemic-like proportions of our country's scamming problem.

Why legislation must be improved and loopholes must be closed

A basic principle of law is that anyone who wants to take part in an activity that poses a high risk to the public should be regulated. If you want to own firearms for sport, drive a car, or offer investment securities to the public, you need to register yourself with the authorities. The law does not say you cannot do it, but if you are, you have a duty to show you are doing it responsibly.

But did you know there is a loophole in UK firearms legislation that allows you to own a high-powered assault rifle, as long as you put a sticker on it saying, "This Is Not an Assault Rifle"? And that even if you start walking around in public waving your not-an-assault-rifle in people's faces, the police will take no action until people start getting hurt?

No there isn't, *because that would be utterly ridiculous.* Yet this is the situation that UK legislation allows in the offering of unregulated investments to the public.

Unlike firearms, collapsed unregulated schemes do not kill people, but the impact on people's lives is often comparable to losing a limb, losing a loved one or suffering a chronic illness.

Legislation is progressively improved over time, usually after a disaster has made the failings of the existing legislation clear.

Any securities offering to the public should be registered with the FCA

UK financial services law is 86 years out of date and counting. In the United States, all investment offerings to the public are required to register with the Securities and Exchange Commission (SEC). The relevant US Securities Laws were enacted following the 1920s when companies often sold stocks and bonds on the basis of glittering promises of fantastic profits and without disclosing meaningful information to investors. Following the stock market crash of 1929, the U.S. Congress enacted the federal securities laws and created the SEC to administer them.

The Securities Act 1933[1] https://sec.report/Form/Securities-Act-of-1933.pdf regulates offers and sales of securities in the United States and requires the company to file a registration statement containing information about itself, the securities it is offering, and the offering. While registration statements are selectively reviewed by SEC staff, the SEC does not evaluate the merits of securities offerings, or determine whether the securities offered are "good" investments or are appropriate for a particular type of investor. A registration statement must be declared “effective” before it can be used to complete sales to investors.

As part of their registration they must provide accurate information on the investment offering and their financial position, certified by independent auditors. They must then file updates on a regular basis, also audited.

This does not make it impossible to run an illegal investment – nothing will. It does however make it a lot more difficult, because a) there are far fewer loopholes in what can be promoted to the public, and b) the requirement to publish accurate and timely information is more difficult to get around.

There is an equivalent UK requirement. It is currently derived from the EU Prospectus Regulation which requires a Prospectus for any offer of a security to the public.
The key elements of the Prospectus Regulation regime are copied over into the FCA Handbook, see: https://www.handbook.fca.org.uk/handbook/PRR/1/2.html PRR 1.2.1 copies Article 3(1) of the Prospectus Regulation which provides “Without prejudice to Article 1(4), securities shall only be offered to the public in the Union after prior publication of a prospectus in accordance with this Regulation.” That requires a prospectus approved by the FCA acting as UK listing authority.

[1] https://en.wikipedia.org/wiki/Securities_Act_of_1933 https://sec.report/Form/Securities-Act-of-1933.pdf

There are a number of key exemptions to the Prospectus requirement. An offer is not made "to the public" if the conditions set out in Article 1(4) of the Prospectus Regulation (see PRR 1.2.3) are met: these include (i) an offer of securities addressed solely to qualified investors; (ii) an offer of securities addressed to fewer than 150 natural or legal persons per Member State, other than qualified investors; (iii) minimum investment of at least EUR 100 000.

We are concerned that the UK equivalent requirement to the SEC is not being properly used.

The UK Government should immediately introduce legislation requiring any entity offering securities to the public (see PRR 1.2.3EU21/07/2019) to:

1. Register their investment offering with the FCA.
2. As part of that registration, provide comprehensive information regarding their business plan, existing financials, and projected cashflow, audited by an independent accountant.
3. Provide full updated accounts to investors on a six-monthly basis. No company offering securities to the public should be allowed to use "small company" exemptions from publishing full accounts. Any failure to file accounts on time should trigger an immediate investigation.

In the case of GPG as an example, no accounts were filed after 2015 but monies were poured into the scheme for a further 4 years.

The definition of a "security" should mirror that used in the US. Contrary to myth, the definition of what is and isn't a security is well-defined and has been since the "Howey Test" was established in law in 1946.

None of this is impossible, disproportionate or unaffordable - this is how it has worked in the US for decades. Furthermore, the "restricted investor" definition (people who can have ultra-high-risk unregulated investments advertised to them if they promise not to invest more than 10% of their capital) should be abolished. It is completely unenforceable.

By making the register publicly available it could then become a 'white list' whereby any investment not on it would be unlawful. As such the list could be used by pension trustees, ISA managers, banks, building societies etc, to screen their clients' transfer requests. It would also be beneficial to individual investors who could easily use it as a basis to screen out unsuitable investments.

In conclusion to this part of our response, we hope that the critique of the FPR as set out above serves to show the enormous scope for improvement in that particular area; and thereby how the limited resource available could be utilised far more effectively if regulators were to perform better in the prevention space.

Please note, as mentioned earlier, FPR is just one of many areas that require an overhaul of the way our regulators operate.

2. Concerns about governance of the FCA

We are concerned that the FCA's governance arrangements align it too closely with industry and Treasury interests, leaving it insufficiently answerable to the consumers and citizens in whose interests it is intended to act.

We propose (see Appendix III) that a new body, the Financial Regulator's Supervisory Council (FRSC), be created to ensure that the FCA is, for the first time, directly accountable to consumer, as opposed to producer, interests. Its responsibilities would include:

- Hire, review and fire powers in relation to:
  - The Chair and Chief Executive of the FCA, jointly with HM Treasury;
  - The two Non-Executive Directors of the FCA currently appointed by the Department for Business, Energy and Industrial Strategy;
  - Members and Chair of the Financial Services Consumer Panel;
  - The Financial Regulators' Complaints Commissioner;
  - Such employees as the FRSC requires to perform its statutory role
- Where appropriate, to commission, review and oversee implementation by the FCA of recommendations of:
  - Periodic Reviews of 'the economy, efficiency and effectiveness with which the FCA has used its resources in discharging its functions';
  - Periodic Reviews of the FCA's treatment of whistleblowers and its response to the evidence they provide, an area in which there are significant concerns about its performance[2];
  - Independent Reviews of the FCA's conduct in circumstances in which there are reasonable grounds for believing that there has been material regulatory failure
- To establish operating guidelines for the operation of the Complaints Scheme insofar as it relates to complaints about the FCA, and to monitor the effectiveness of the Scheme and of the FCA's responses to it;
- To act as a designated consumer body by order of the Treasury in submitting, where appropriate, super-complaints to the FCA should it identify examples of market behaviour which it reasonably believes are operating against the interests of consumers;

[2] https://www.moneymarketing.co.uk/news/fca-took-significant-action-in-less-than-1-of-whistleblowers-reports-last-year/

- To publish white papers, consultation responses and other documents intended to contribute to debate about financial services regulation in the UK;
- Ensuring that the FCA is playing a leading role in the development of an international approach to financial regulation that is joined-up and effective
- Once a year, or additionally on request, to report to the Treasury on its view about the performance of the FCA and suitability of the regulatory environment, together with any recommendations for change

Part 2: Our response to the specific consultation questions

1 How can the UK financial services sector take advantage of the UK's new trading environment with the rest of the world?

Given Transparency Task Force's overarching mission to promote reform of the financial sector so it serves society better, you might expect us to be disinterested in the commercial opportunities afforded by the UK's increasingly globally-focused trade policies. In fact, the opposite is the case: we believe that there is the potential for the UK to prosper through the creation of well-paid jobs and increased tax receipts if, as we hope, it is able to continue to grow its financial sector.

The principal factor risking this virtuous circle is that a small number of poorly led, large incumbent firms lobby successfully for weak and captured regulation, resulting in our financial services industry earning an ever worsening reputation for poor treatment of customers, misconduct and worse. In a global marketplace, the UK cannot afford to be perceived as anything less than the zenith of best conduct, the consequence of having the most rigorous and effective regulation. A deservedly imperfect reputation could result in the City being denied an equivalence-based trading relationship with the European Union and being excluded from other free trade agreements.

So while we focus principally on how the UK's decision to leave the regulatory ambit of the European Union presents an opportunity to improve regulation so it better serves the interests of wider society, we do so in the knowledge that it is only by achieving this goal that we can hope to preserve and extend the global footprint of a vital sector of our economy.

2 What changes should be made to the UK's financial services regulations and regulatory framework once the UK is independent of the European Union?

The principal effect of the Financial Services and Markets Act 2000, which could be seen as a key step in the UK's regulatory alignment with the European Union, was to replace 'patchwork quilt' regulation, which carried risks such as under- and over-lap and regulation shopping[3], with an *omniregulator*, the Financial Services Authority.

The FSMA over the past 20 years has slowly diverged from what worked best for the UK's markets, especially in regards to attempting to view the entirety of the financial system through a single lens. A more nuanced approach that recognizes the financial system is a social system composed of multiple different communities that have different needs, in terms of oversight, protection and enforcement is needed - see Appendix I.

Omniregulators are subject to intrinsic tensions between their core functions of (i) promoting financial stability and (ii) ensuring there's effective competition and fair treatment of users of financial services. The former is best achieved by the evolution of a market that contains a small number of large, well-capitalised participants that extract economic rents, the latter by a diversity of challengers that innovate and treat customers well. Moreover, a single, monopolistic regulator may be more vulnerable to regulatory capture.

The worst possible combination of these risks - an omniregulator that encourages concentration among systemically important institutions such as banks, yet is captured and hence fails properly to supervise their stability - came to pass in the UK between 2003 and 2008, and was a major causative factor in the Global Financial Crisis (GFC). Government responded by abolishing the FSA and replacing it with *twin peaks* regulation: a *stability* regulator for systemically important banks and insurers, the Prudential Regulation Authority, under the aegis of the Bank of England, and a *conduct* regulator and supervisor of non-systemically important firms, the Financial Conduct Authority.

Not only has the FSMA model and overall framework itself been problematic; but the failure of the operation and execution of this model as highlighted by the recent Gloster and Parker reports into FCA regulatory failure. In particular there has been a failure to protect retail consumers and reduce financial crime.

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[3] Firms configuring or presenting activities in order to exploit regulatory underlaps or fall under the aegis of whichever they considered to be the least effective regulator

While FSMA remains in force, its key policy became discredited in 2007-8 and was abolished with effect from April 2013. The Act has been modified since, and many of its provisions supplanted by those contained in the Financial Services Act 2012. It would therefore be more accurate to say that the UK financial services industry now operates under the *2012 Act* model, and to consider to what extent it is appropriate and effective going forward.

Memories of the Global Financial Crisis are still relatively fresh, and while regulatory capture of the PRA remains a risk, to date it is generally considered to be performing well. As a result, it is not the principal focus of our response to this consultation exercise.

In contrast, when the discredited FSA was abolished, many of its functions and personnel continued in the FCA, which remained in the same building. The ongoing problems at the FCA since this time would suggest that perhaps the transformation from the FSA to the FCA was more about a rebranding exercise rather than substantial reform. By April 2016, concerns were widespread from industry and consumer representatives alike that the FCA was a 'timid and cowed' regulator, overly obsessed with box-ticking, subject to groupthink, lacking in transparency and in need of an independent evaluation authority to measure its effectiveness.

These concerns have since intensified. Independent Reviews into the regulator's handling of two failed (suspected fraudulent) collective investment schemes, Connaught and London Capital and Finance, published in December 2020, were both highly critical. The latter has resulted in the Treasury indicating that it is considering the establishment of a redress scheme. The former has not yet, largely because the FCA has falsely claimed that investors in the scheme are not out of pocket[4].

While the terms of reference under which the reviewers operated restricted them to identifying specific, actionable *lessons learned*, we believe it is essential also to recognise and address the underlying problems that emerge from the two reports. Both paint a picture of a low-energy regulator that is complacent, slow and reluctant to act, operates in silos, treats whistleblowers and their evidence with contempt and lacks transparency and accountability.

[4] The FCA achieved this by retrospectively describing income paid to investors during the Fund's life as returns of capital and by ignoring the consequential losses and opportunity costs that inevitably accrued in the period of almost nine years between the Fund's suspension and the publication of the Independent Review

Merely trusting that the FCA implements the specific recommendations contained in the two reviews does not tackle these deep-seated causes. And there are doubts about the FCA's willingness and ability to action even that limited degree of reform[5].

Moreover, there are a great many other cases in which consumers and small businesses have suffered losses as a result of a similarly toxic combination of alleged industry misconduct or misadventure and regulatory failure by the FCA. An Independent Review into the FCA's Interest Rate Hedging Product Redress Scheme is due to be published early in 2021, while a bank-commissioned one into what senior managers knew and allegedly concealed about the HBoS Reading Fraud - which will raise grave questions about what the regulator also knew, and what it did with that information - is expected before the end of the year. And there are many more cases in which regulatory failure and worse are either suspected or confirmed, victims in which are keen for similar reviews to be commissioned.

These include, but are not limited to:

- The Woodford Equity Income Fund
- Defined benefit pension liberation scams (not least British Steel)
- Blackmore Bond
- Lendy
- Funding Secure
- Store First/Park First
- Dolphin Trust
- PremierFX
- Authorised Push Payment frauds
- Misrepresentations and misselling of regulated and unregulated consumer credit (i.e. loans) (with or without BNPL promotions)
- Currencies and transfer working group and lack of guidance to increase transparency for consumers.

We also note recent comment in the Financial Times about the FCA's performance[6]. Jonathan Ford writes:

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[5] New Chief Executive Nikhil Rathi has been criticised for employing Megan Butler, who was heavily and justifiably criticised in the LCF report, and we believe would have been similarly found responsible in the Connaught one had it named the relevant executives, as Executive Director for Transformation responsible for leading the change programme. The role was not advertised externally.

[6] Financial Times 8th February 2021 - 'It's boom time for investment fraud in Britain'

“As for the watchdog’s own record at throwing the legal book at offenders, a recent Freedom of Information request summarises its lacklustre record. In 2018 the FCA disclosed it received almost 700 fraud complaints. Yet it opened on y 40 investigations in the past two years and none resulted in a prosecution let alone a conviction”.

On this basis, approximately 0.6% of complaints resulted in a prosecution. This is what makes fraud and bad behaviour by firms attractive business. The odds on getting caught by the regulator are minuscule and the odds of being convicted are as close to zero as you possibly get.

Radical remedial action is urgently required. Thoughtful, deliberate action needs to be taken to better serve the needs of the market, the regulator(s) and individuals.

We believe that there is a compelling requirement for the UK to establish a process that is akin to The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry that took place in Australia (2018-9) to effect a fair resolution of the many legacy cases of regulatory failure and industry misconduct that have already come to light, and doubtless others that have yet to be recognised.

Full consideration of the merits of and a possible constitution and remit for such an entity is beyond the scope of this consultation; we believe that a further such exercise, or perhaps a fully independent, properly resourced and forensic Public Inquiry, is needed, to establish these parameters. However we observe that the following overall goals might be pursued:

- The creation of a protected environment in which industry participants can admit to past misconduct and the FCA to regulatory failure, perhaps with the incentive of immunity from civil and criminal consequences if the victims of these legacy cases are fully compensated and all those responsible permanently leave the sector;
- Transparent and constructive dialogue about how a fit-for-purpose regulator can be formed out of the existing FCA or a new entity created to replace it;
- Open discussion with Government about what, if any, legislative changes are needed to deliver the above

Following the termination of the Transitional Arrangements governing the relationship between the UK and the EU on 31 December 2020, UK financial services hope to trade with the EU on the basis of an equivalence regime. Any such agreement is likely to be time-limited and severable should the UK’s system for financial regulation be deemed to be materially deficient. Until the Treasury accepts that the FCA needs to be fixed or replaced and shows that it is taking the steps needed to do so, there is a material risk that UK financial services could lose access to EU markets. Honest protagonists in the industry should therefore be aligned with consumers in lobbying for this process to get underway as soon as possible.

Throughout this response document, we identify shortcomings and opportunities for improvement in the existing arrangements, principally based on ideas to improve its governance, guard against regulatory capture and boost transparency. Nothing in our willingness to do so should be taken as contradiction or dilution of our core point, namely that there needs to be a fundamental consideration of whether the FCA survives, if so how it changes and if it were to be replaced, with what.

Much of our response document focuses on one of the FCA's three statutory objectives - protecting consumers. We do so because of the urgent need for action created by the swelling number of legacy cases in which regulatory inaction has led to consumer harms and the prevalence of financial scams being promoted online. We recognise that significant improvements are also required to the regulator's promotion of competition and guardianship of markets, but believe that the improvements to oversight and accountability outlined in this document will have benefit in those areas too, as well as creating an environment in which consumers will be better protected.

Regulation incurs costs (both private and public) to the UK economy. It is needed however in order to protect all users of UK financial services (including domestic consumers and foreign investors). If the UK financial services industry is to be seen to be a competitive and safe place to do business, it is vital that the regulation is effective.

Currently, there is no requirement within the FSMA that holds the FCA to account when it does not enforce the FSMA (even when there are catastrophic consequences of not doing so, to lay and professional users of UK financial services). To date, almost 5 years since the introduction of the SM&CR, the FCA is yet to make a single enforcement of the SM&CR. Principles based regulation that is rarely or never enforced is worse than pointless; it encourages the poor conduct it seeks to prohibit. The regulatory framework should be changed so that the FCA has <u>obligations to enforce</u> them (including holding FCA Senior Managers to the same standards as the FCA ought to hold Senior Managers within the financial services industry).

The total failure of the FCA to enforce the SM&CR over the course of its 5 year history is of the most profound concern. It strongly suggests that the FCA is, like its predecessor the FSA, unfit for purpose.

There are some who see Brexit as an opportunity to simplify or replace the FCA Handbook, arguing that it is unnecessarily complex. We endorse the idea, in principle - provided it does not mean that rules are also made less effective. Generally, rulebooks that are long and complex create, whether intentionally or accidentally, ambiguities and contradictions. These may make good-faith compliance harder and bad-faith avoidance easier.

We are concerned that the FCA's Principles for Business do not work in practice because breaches of them do not provide grounds for civil claims by those who lose money as a result and also do not give rise to an obligation on the regulator to enforce. Very often, there are no adverse consequences to breaching; under such circumstances, they are merely platitudes, not principles.

Transparency Task Force has consistently argued in its responses to consultations that there needs to be a legally-enforceable fiduciary duty of care on the part of authorised firms and individuals, breach of which can be actionable for damages by the victims, together with a duty of care on the regulator to undertake appropriate enforcement action, combined with a reversal of its general immunity from civil liability. We are also broadly supportive of longstanding calls for this duty of care, and the regulatory perimeter, to be extended to include small and medium-sized businesses, where these are customers of authorised financial services firms.

The recent LCF scandal highlighted this concern in conjunction with the lack of data intelligence and any well-defined process within the FCA of referring and escalating alleged fraud when the call centre received warnings of alleged fraud. Warnings of alleged fraud from IFAs, whistleblowers or retail consumers are a key tool in the fight against reducing or mitigating financial crime which can cause serious consumer detriment. As mentioned earlier, Parliament should mandate that one effective body is nationally responsible for dealing with fraud. There needs to be a joined up approach between the FCA and this body such that the risk of another LCF is significantly reduced.

Furthermore, in the light of LCF and similar cases and to improve transparency and consumer protection in the future, regulated firms should not be allowed to sell unregulated products, or the perimeter should be flexed so any product sold by a regulated firm is deemed to be regulated.

Finally, while the UK operates a relatively straightforward 'twin peaks' regime for core regulated financial services, there are over 700 regulators in the UK with over 41 regulators for the wider financial sector alone and at least 14 dealing with accounting, auditing, insolvency and some aspects of corporate governance. These regulators are often inefficient in duplicating work, overlapping in responsibilities and introducing passivity as each expects the other to act. Despite the multiplicity of such regulators, there is no central enforcer of the corporate law and there is little joint collaboration between these regulators to address corporate malpractices, auditing fiascos, and other predatory practices. At the same time, there is little representation of the rights of the consumers. For a more detailed overview of this problem see Sikka, et. al (2019) report on Regulatory Architecture to Enhance Democracy and Business Accentuality.

This complexity is a particularly acute problem when fraud is alleged. Too often, investigation and enforcement against fraud, especially that relating to financial services, simply does not occur because it is deemed to be not wholly within the purview of one body (so it doesn't get tackled at all). Parliament should mandate that one effective body is nationally responsible for dealing with fraud. The latter point is picked up in detail at Appendix II, written by Anthony Stansfeld, the Police Crime Commissioner for Thames Valley.

3 What should the Government's financial services priorities be when it negotiates trade agreements with third countries?

The Government should ensure that all financial services offered to customers in the UK, irrespective of where those services are delivered, are regulated to a standard at least equivalent to that set out by statute as being applicable to services delivered in the UK. Any failure to achieve this goal would create an opportunity for the industry to embark on 'jurisdiction shopping', by establishing letter-box businesses offshore through which they could offer services to clients in the UK without being subject to the same regulatory standards. Likewise, such services should be covered by the Financial Ombudsman Service and Financial Services Compensation Scheme or, where equivalent or superior, local versions.

Wherever possible, in situations in which a counterparty nation's financial services industry is subject to higher regulatory standards than the UK's, then that country's rules should prevail in addition to the UK's, where not contradictory. This would open up the possibility of UK customers choosing to transact with firms in other jurisdictions in any niches in which they perceive regulation to be superior, creating pressure on the domestic industry to lobby for enhanced UK regulatory standards. Market forces will thus encourage a global Britain to lead the world in financial regulation and consumer protection, not only strengthening its ability to retain home clients but also establishing the UK as the world's foremost financial services centre, the provider of choice for consumers and firms worldwide.

For the same reasons, when the UK financial services industry is granted access to overseas markets under free trade agreements it should be required to meet the higher of the UK's and the counterparty's regulatory standards.

4 Should the UK open its financial services markets to external competition from countries outside of Europe, or should the UK maintain the current regulatory barriers that apply to third countries?

Subject to the considerations outlined in our response to question 3, above, and for the reasons given there, the UK should open its financial services markets to firms from all third countries, including those that are members of the European Union, in return for reciprocal rights of market access.

5 What skills and immigration policy will the UK financial services sector need once the UK has left the European Union?

This question strays too far from our mission as an organisation for us to be able to offer a valid response.

6 How can Government policy and the UK regulators facilitate the emergence of FinTech and new competition; develop new areas of growth for the financial services sector; and promote the UK as the best place to incubate new financial technologies and firms?

The UK must learn from, and not repeat, mistakes made in the recent past, particularly those made in relation to the regulation of peer-to-peer lending and equity crowdfunding. Initially 'virtually unregulated', the sector attracted a mix of the well-intentioned but incompetent and also the dishonest. In too many cases, consumers were encouraged to provide loans or investment to counterparties on the basis of representations that were either materially incomplete or misleading, with there sometimes being undisclosed financial or other links between the counterparties and those operating the platforms.

As with many aspects of UK financial services conduct regulation, the FCA urgently needs to become more alert to the concept of fraud and more proactive in its supervision of firms *ex ante*, as well as more muscular and assertive in its use of enforcement action *ex post*, to remove bad actors and deter prospective malevolent market entrants.

In principle, the FCA's regulatory sandbox is a positive initiative, lowering the barriers of prior compliance expertise and financial resources needed for prospective market entry by pressing some of those costs onto the regulator through the provision of guidance and mentorship. Anything that adds to consumer choice without compromising standards is to be welcomed.

Given our concerns about the culture and governance of the FCA, there may be a risk that its teams working on the sandbox initiative may see it as their role to help firms achieve restricted or full authorisation, whereas in fact it should be to help them achieve the inviolable standards that warrant the granting of such rights.

7 Through what legislative mechanism should new financial regulations be made?

8 How should new UK financial regulations be scrutinised?

We have combined our response to question 7 and 8.

There are ongoing tensions between the FCA and Parliament: the former blames shortcomings in the legislation (for instance, with regard to the lack of clarity about the regulatory perimeter, or limits to the Senior Managers and Certification Regime) for its failures, while Parliament blames the regulator for not asking for such changes *ex ante* then blaming lawmakers *ex post*.

Likewise, victims of regulatory failure and campaigners who engage with the Treasury, particularly in the shape of the Economic Secretary to that body, about shortcomings in the regulatory regime, often find it fruitless. Typically, the response they receive is that the FCA is independent and therefore Ministers cannot intervene.

It is therefore clear that change is required. The principle that law is made by our elected representatives and upheld by government departments and statutory bodies is an important one, but it should be incumbent on such organisations to be transparent in requesting any changes to the law. So the Chief Executive of the FCA might be required to report annually to Parliament on what if any legislative changes he or she would like to see, and on the implementation of any that have taken place in the recent past.

Likewise, the delineation between the responsibilities of the FCA and the Treasury should be made clearer. Any changes to the law would normally be proposed by the Treasury, which also plays a part in the governance of the FCA through the appointment of its Chair and Chief Executive[7]. Its role in drafting legislation should remain, but be made more responsive as described above.

Crucially the policy making process must be made more transparent. There are useful mechanisms for scrutinising legislation which can and should be applied. We suggest the following:

[7] subject to the approval of appointments by the Treasury Committee

- Using the Cabinet Office guidance for consultations. Crucially this would give vital time for scrutiny of proposals and better understanding of the feedback and rationale for moving forward with the particular pathway
- Publishing policy road maps that are subject to consultation and transparent feedback
- Utilising working groups made up of industry, consumer representatives, and technical experts with public memberships, terms of reference, minutes, and allow for feedback from non-participants
- Delegating an oversight role to a specialist financial services sub-committee that would report into and be represented on the Treasury Select Committee
- Hold public consultations early on in the policymaking phase

The Transparency Task Force believes that regulators should be accountable to our elected representatives, both operationally and in terms of setting and amending regulations. It has successfully campaigned for and engaged with two Select Committee inquiries and provided written and oral evidence to both of them.

We recognise that the Treasury Committee performs an important role in overseeing the FCA, but believe that this function could be expanded. Prior to its scrutiny sessions with the FCA's Chair and Chief Executive, which take part typically twice a year, it could launch a call for evidence, providing those with concerns or constructive suggestions with an opportunity for their evidence to be considered by the Committee and, where appropriate, put to the regulator's officers. A similar approach could be undertaken prior to appointment hearings for those two top positions.

The right of the Treasury Committee to block appointments to those two positions proposed by the Treasury should be inviolate, and should be exercised where appropriate. These principles were undermined in 2012, when John Griffith-Jones was appointed to the post of Chair of the FCA by the Treasury without a pre-appointment hearing, supposedly on the grounds of market sensitivity. Mr. Griffith-Jones had led KPMG, first in the UK and subsequently globally, during a period when banks' published accounts were, at best, optimistic representations of the actuality. In a number of those cases, KPMG was the auditor. Among these was Halifax Bank of Scotland, which became insolvent and was rescued by Lloyds Banking Group. Mr. Griffith-Jones was subsequently criticised for initially failing to recuse himself from FCA board discussions about that bank's collapse, and members of the Treasury Committee called for his resignation or removal. We believe that a pre-appointment hearing, especially if preceded by a public call for evidence, would have prevented him from being appointed.

We are concerned that the effectiveness of the Committee, and perhaps also of the Treasury and the Economic Secretary to the latter, can sometimes be undermined by the practice of secondment of employees that appears to be entrenched in the culture of the financial services industry and those who should be holding it to account.

We are aware of two instances in recent years of private secretaries to the Minister and one of a member of the Treasury Committee secretariat being seconded employees of the FCA. This represents an obvious conflict of interest, as those employees may have been tempted to alert their employer to criticism of it submitted to the organisations to which they had been posted. It also risks undermining the confidentiality that members of the public have a right to expect when corresponding with politicians and government departments.

We believe that the Treasury and Treasury Committee should return any outstanding secondees from the FCA, the Financial Ombudsman, the Financial Services Compensation Scheme, the financial services industry and the professional services firms that serve it, should not accept new secondees and should not second its own employees to those entities.

Finally, we believe that there should be a significant role for Parliament in establishing a Royal Commission to deal with legacy cases of regulatory failure and determine the future of the FCA, that the Treasury Committee should hold regular evidence sessions with a new body established to improve governance and accountability of the FCA[8], and that the new body's annual reports should be presented jointly to that Committee and the Treasury.

[8] See Part 1(2) and Appendix III

9 What progress has the Government and regulators made in facilitating key financial services equivalence agreements with third countries; and would an alternative mechanism serve the interests of the UK market better?

This lays outside our mission and expertise.

10 How should financial services regulators be funded?

We have chosen to not respond to this question at this time.

11 Should the mandate and statutory objectives of the financial services regulators change to include wider public policy issues?

We strongly endorse the principle that the UK should aim to maximise the global competitiveness of its financial services industry. However we oppose any suggestion that the regulators should have a statutory obligation to achieve this goal, because introducing one would send the FCA a highly damaging signal, namely that there is some way to make our industry competitive that does not involve the three existing statutory goals.

On the contrary, it is only by ensuring that consumers are well protected, that there is robust competition and that markets truly function with integrity and resilience that the industry can flourish, both domestically and internationally.

We have already explained that inadequate regulation could jeopardise the UK financial services industry's access to EU markets under a hoped-for equivalence regime.

Regulating financial services so they work well for end users is, in the long run, the only way to guarantee that the industry is globally and sustainably competitive. Pretending to do the job well while actually giving some firms a free pass may hand them a temporary advantage, but in the long term they and the entire industry suffer.

As to amending the FCA's or PRA's objectives to reflect other public policy goals, we are alert to the risk of diluting their efforts, and especially those of the FCA at a time when there is legitimate concern being expressed by prominent Members of Parliament about whether it is fit for purpose and an intent to hold a Parliamentary debate about how to fix it. Under such circumstances we believe the focus should be on supporting the FCA by improving governance, transparency and accountability to bring about operationally led performance improvement, rather than adding further to a struggling regulator's statutory duties.

12 How important is the independence of regulators and how might this best be protected?

It is vital that the regulators, and in particular the FCA, should be both *independent of* the financial services industry and the Treasury but at the same time *accountable to* the people, both directly and through their elected representatives. We are concerned that the FCA is currently too close to the industry and the Treasury, and insufficiently answerable to the public and politicians.

Regulatory capture in the main does not mean that individuals become corrupted, whether directly (through financial inducements) or indirectly (such as through the hope or expectation of a revolving-door appointment in the industry, though that can be a factor). Rather, capture can be cultural: hiring people from a narrow pool who have worked in the industry, or for it, or whose friends comprise those who do; governance structures that hand undue influence to the industry and deprive consumers and those representing them equal or greater share of voice; even factors such as locating the organisation in a geography that is proximal to the industry and distant from consumers.

Measures such as Australia's planned introduction of a Financial Regulator Assessment Authority are intended to mitigate this risk by inserting into the regulator's governance structures at a strategic level a high-profile organisation that unambiguously represents consumer interests, whose statutory objectives require it to visibly examine the effectiveness of the regulator.

We propose the UK adopts a similar approach - see Appendix III - but given the size and complexity of the UK's financial services industry, the extent of the shortcomings of the FCA and the urgent need to maintain through equivalence access to EU markets, our proposal for a Financial Regulator's Supervisory Council (FRSC) goes further, adding shared responsibility for the hiring, review and firing of the FCA's Chair and Chief Executive, sole responsibility in those areas for two of its non-executive directors, members of the Financial Services Consumer Panel and the Financial Regulators' Complaints Commissioner (approximately 90 percent of whose work relates to the FCA).

We provide as an addendum advice provided to the Australian Royal Commission of Inquiry into Misconduct in the Banking, Superannuation and Financial Services Industry (2019) (FSRC / Hayne Commission). The FSRC in Australia found extensive evidence that Australia's regulators - the Australian Securities and Investments Commission (ASIC) and the Australian Prudential

Regulation Authority (APRA) - were captured. As a consequence it called for the advice - set out in Appendix IV - and reflected the content of that advice in Recommendation 6.14 of the FSRC Final Report (establish a Board of Oversight over ASIC and APRA to mitigate capture). That recommendation mirrored a similar recommendation made by the Australian Financial System Inquiry (FSI) in 2014 (Murray Inquiry), which conducted an extensive review of Australia's financial regulatory architecture, and reached the same conclusion: a need to establish a board of oversight over the regulators to mitigate capture ('Financial Regulator Assessment Board' to use the terminology of the 2014 FSI). Those recommendations - that of the FSI in 2014 and the FSRC in 2019 - was subsequently reflected in the *Financial Regulator Assessment Authority Bil* (FRAA), currently before Australia's Federal Parliament. This development - the establishment of the FRAA - will be the most significant reforms and enhancements to the Twin Peaks model since the model was first adopted in Australia in 1997, and represents a deeply thoughtful analysis of one of the few shortcomings of the otherwise optimal regulatory model (Twin Peaks), namely that the Twin Peaks architecture includes no measures to combat the extensively internationally observed tendency: that regulators of all industries are susceptible to capture, but none more so than regulators of the financial industry.

Because the literature on, and research into capture is international and extensive (dating back to the observations of Charles Francis Adams Jnr in the 1860s), and because the invited submission to the FSRC provides an extensive analysis of the both the literature and the evidence as observed in the world's original Twin Peaks jurisdiction, we are of the view that it would potentially be of greater use to this inquiry to provide a copy of the invited submission made to the 2019 Australian FSRC, than to attempt to summarise its extensive findings. Hence its inclusion as an addendum.

We commend this development to the inquiry and urge the inquiry to give this alternative serious consideration, particularly in light of the findings handed down in the Gloster and Parker reviews into the collapse of LCF and Connaught respecticvely, and the evidence of capture of the FCA expressed and implied in those reports.

Furthermore, we also provide, as an additional addendum, a copy of the very latest research which is as yet unpublished, by the leading scholars in the field, who have analysed the *Financial Regulator Assessment Authority Bil* (FRAA), currently before Australia's Federal Parliament, and have provided analysis of where and to what extent that legislation can be enhanced, so as to ensure that the FRAA, when created, will have the greatest chance of success; will be most efficacious in mitigating future capture of ASIC and APRA; and will itself be optimally constituted so as to most effectively resist itself becoming captured. We commend this research to the inquiry as a valuable template for consideration in adoption of similar reforms.

We draw to the inquiry's attention the phenomenon known as the 'revolving door'. Again, the literature and international scholarship investigating this phenomenon is extensive. On 29 January 2021 the authors of this submission conducted a consultation with Dr Michael Taylor, who originally conceived the Twin Peaks model in 1993. In that conversation Dr Taylor - speaking in his personal capacity - specifically mentioned the need to align regulator's incentives correctly, and mitigate the worst effects of the revolving door. With that in mind we attach, as an addendum, a chapter from the forthcoming *Cambridge Handbook of Twin Peaks Financial Regulation,* (Godwin & Schmulow, eds, (forthcoming March/April 2021)) which details the steps taken in South Korea to limit the 'revolving door', through the enactment of the *Public Service Act* (PSA). That legislation prohibits employment with a regulator within 3 years of employment in a regulated entity. While the implementation of the PSA in South Korea has been imperfect, we are nonetheless of the view that the Korean legislation in this regard is worth studying, and we commend to the inquiry the Korean approach to resolving this problem.

We would also like to mention that we believe the FCA should fully embrace the idea of a 'Duty of Care.' The TTF responded in full to the FCA's Duty of Care Discussion Paper back in November 2018. Our response can be downloaded here.

We are concerned that the FCA is not sufficiently accountable to non-industry stakeholders - principally, consumers and Members of Parliament. To give just one example, it was apparent for many years that regulatory failure had occurred in relation to The Connaught Income Fund Series 1, and yet both the regulator and successive Economic Secretaries to the Treasury refused to commission an investigation, despite requests from affected consumers and concerned MPs. Instead, the FCA was allowed to commission a 'light touch, lessons learned review', and only in 2019 (seven years after the Fund was suspended); and because it was allowed to control the choice of reviewer, terms of reference and protocols, the exercise was less effective than the statutory review conducted in the parallel London Capital and Finance case. Had there been a statutory obligation on the Treasury to commission such a review as soon as regulatory failure became apparent, a more effective review would have been commissioned in 2012 and its findings implemented in ample time to prevent LCF and many other examples of regulatory failure.

It is vital that any enhanced coordination between the Treasury and regulators (principally the FCA) occurs in public, to mitigate the risk of regulatory capture. There are many secondments of executives from the industry and the professional services firms it engages to the Treasury, some to the FCA and revolving-door hires from both organisations into those businesses; it is therefore crucial that there is sufficient consumer input and that all relevant discussions are published and placed before Parliament.

It is good that the FCA and Treasury periodically launch consultation exercises, but it must be remembered that there is not equality of arms between industry and consumer interests, or between large and small firms, in such processes. Large firms have public affairs departments and consultancies at their disposal, which provide them with the resources necessary to provide detailed and closely argued response documents. Moreover, in game theoretic terms, the payoffs for them in securing their strategic goals through influencing policy outcomes are sufficient to justify such investment. In contrast, individual consumers are unlikely to even be aware of live consultations, and for them any wrongs they've suffered may well be a one-time game, so there is no payoff for making the investment of time required to participate. Even an organisation the size of the Transparency Task Force relies largely on volunteers to produce documents such as the one you are reading.

Creation of the FRSC would mitigate this imbalance to a large extent, particularly if the FCA and Treasury were required to place appropriate weight on its inputs). For the first time, there would be an umbrella organisation representing the interests of the users of UK financial services, funded by a modest top-slice of the FCA's annual income. It would therefore be able to employ professional researchers to contribute to consultations, and would also have the resources to consult with and obtain inputs from single-issue action groups and individual consumers.

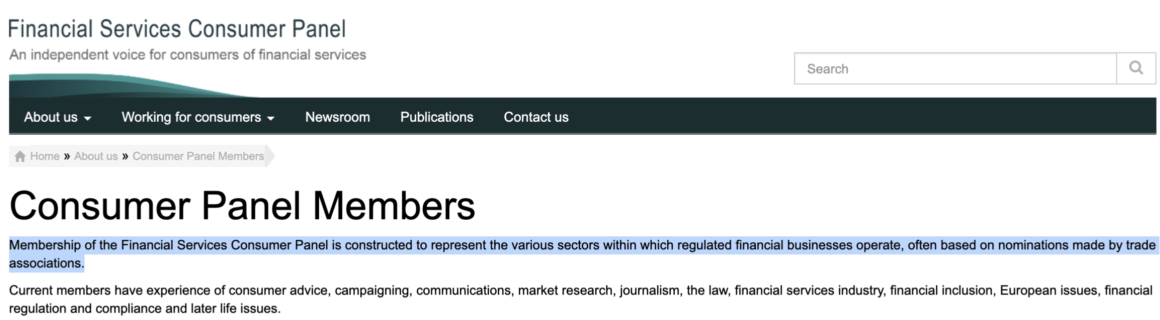
The FCA operates what it terms its Consumer Network, which it claims to consult proactively around twice a year; it also claims to contact member organisations about relevant consultation papers. In the case of CP20/11, the Regulators' consultation on changes to the Complaints Scheme, we learned that the FCA began making that approach barely more than a fortnight before the original deadline for the submission of responses. The FCA has refused to provide a complete list of the Network's member organisations, nor has it explained how they were chosen.

We believe that this network should be opened up to all organisations that can make a reasonable case to represent consumer interests in UK financial services, that its meetings should be public and minuted, that due weight be given to its inputs to consultations and that it be given the right to make 'super complaints'[9].

We have grave concerns about the role of the Panels in the governance of the FCA. These include:

- The FCA has three industry Panels (four if you include the Listing Authority Advisory Panel) but only one consumer one, implying over-representation of producer interests and under-representation of consumer ones;
- Members of the industry Panels are largely nominated by trade associations and rubber-stamped by the FCA. In practice this gives those organisations considerable influence over FCA policy and operations, especially given that the FCA refuses to say which member was proposed by which organisation, or to publish the minutes of Panel meetings;
- The Financial Services Consumer Panel does not, in practice, represent consumer interests effectively

It might be worth providing more detail on our allegation that the Consumer Panel does not represent consumer interests effectively. The first point to note is that the 2012 Act places on the FCA statutory obligation to 'secure that membership of the Consumer Panel is such as to give a fair degree of representation to those who are using, or are or may be contemplating using, services otherwise than in connection with businesses carried on by them.' And yet the Panel's website, which is provided and managed by the FCA, admits that the membership is constructed to represent the sectors in which regulated financial businesses operate, and that appointments are often based on nominations made by trade associations:



[9] Complaints about thematic issues affecting consumers, that the FCA is obliged to investigate

The Transparency Task Force is aware of one individual, who leads an action group representing the victims of a financial services regulatory failure case, being told that he could not join the Consumer Panel because 'he might criticise the FCA.' He campaigned for the right of the Panel to make constructive criticisms of the FCA, consistent with the 'comply or explain' provisions set out in the 2012 Act; as a result, the FCA agreed a memorandum of understanding with the Panel under which it could criticise the regulator, provided it first gave notice of its intention to do so. This right has seldom been used.

Our proposal to create the FRSC would eliminate these problems by handing that statutory body responsibility for selecting Panel members and empowering it to censure the FCA's leadership if it attempted to constrain the Panel's freedom of speech. This right could further be protected by requiring all Panel proceedings to take place in public, and for transcripts and videos to be made available; it could, for example, operate in a manner similar to a Select Committee i.e. have its meetings on Parliament TV; with appropriate redactions and edits made in relation to sensitive information that ought to be kept confidential.

As far as possible, we believe the FRSC should operate transparently, for example the Panels could hold their sessions in public so far as is possible but went 'in camera' when discussions were genuinely market-sensitive or s348 applied.

Another aspect of accountability is the establishment of whether a regulator is performing effectively, by cost-benefit analysis. It is difficult, if not impossible, to conduct such exercises *ex ante*, but relatively straightforward to do so *ex post*. The Treasury Committee in particular has been keen for some time to establish a robust mechanism for demonstrating the cost-effectiveness of the FCA, and generally to measure its performance.

A conduct regulator exists principally to *prevent harms*. Its performance is therefore best measured by *negative metrics*: the greater the quantum of the harms it fails to prevent, the worse the job it is doing, and vice versa. In the case of the FCA, given its statutory objectives, those measures could include:

- Losses sustained by consumers as a result of authorised firms and individuals treating them badly;
- Excess profits generated by firms as a result of imperfect competition;
- Excess margins earned in the markets through manipulation and other market failures

The Transparency Task Force argued in its consultation response on the changes to the regulators' complaints scheme that the FCA's general exemption from civil liability should be removed. We did so in part because we believe that natural justice requires that the victims of regulatory failure be compensated by the causative agent of such loss, but were also attracted by the principle that only by taking losses currently dispersed among consumers and borne in part by the Financial Services Compensation Scheme and charging them to the FCA, could the true extent of its failures to protect consumers be quantified and made visible to stakeholders, particularly politicians.

Using the same principle, sustained profits substantially in excess of a normal return on capital achieved by certain sectors within financial services[10] are powerful indicators of shortcomings in ensuring that there is sufficient competition, while spreads and abnormal price movements can be signals of failures and collusive behaviour in wholesale markets. Such data should therefore be published and examined.

[10] For instance, asset management and some categories or consumer subsets within general insurance

13 How can the balance between lighter touch regulation and prudential safeguards be best secured?

We believe that prudential safeguards must always take precedence over lightness of touch; but we also hold, as explained in the context of the FCA Handbook in our response to question 2, that effective regulation is seldom complex, and that complex regulation is seldom effective.

To take just one example, individuals and firms authorised by the FCA and appearing on its register are in theory required to act in accordance with the regulator's Principles for Business. Yet when these Principles are breached, and we believe such conduct is widespread, such conduct does not create a civil liability of the perpetrator to the victim, nor does it create an obligation (only the right, seldom exercised) of the regulator to prosecute, fine or ban the individual or firm that committed the wrong. When there is often no consequence to breaching a principle, a cynic might call it a platitude.

Elsewhere in this document we have signalled our support for the introduction of a general duty of care in financial services, obliging authorised firms and individuals to act in accordance with the Principles, requiring the FCA to enforce against them and making both civilly liable for losses caused by failures to do so.

Were this measure introduced it is possible that the Handbook could be simplified and much reduced in scale, cutting compliance costs for the honest majority and lowering barriers to innovation and competition.

14 How should consumer interests be taken into account when considering potential regulatory changes?

Please see our answers to questions 7-8 and 12.

15 What are the strengths and weaknesses of the European Union model of scrutinising financial services legislation?

16 Should the UK seek to replicate the EU's model for drafting and scrutinising financial services regulation?

A response to these questions is beyond our mission and expertise.

Part 3: Appendices

Appendix I:

The Need to be Cognisant of Communities

The financial system is a social system consisting of many different participating communities that individually share common processes, culture, language and purpose. Together, these communities interact to function as a whole. Each community views the financial system in its own context, with its own biases.

The needs of the individual communities also diverge widely, as do their motivations, need for care and oversight, and education. To further complicate matters, individuals may belong to multiple communities at any one time.

What may be fit for one community in many cases does not work another, and taking a monolithic approach to the entire system without thought to the differences of each community will continue to result in friction, lack of transparency, and an inability to support proper functioning of the markets.

Care should be taken to properly model these communities of practice, and understand their interactions, overlaps and dependencies. For example, the functional aspect of retail investors versus institutional investors may be similar on face (buying and selling of securities), but they have vastly different needs in regards to education, protection, registration, market access and more. At the same time, these needs may diverge based on the asset types involved - whether equity, fixed income, derivatives, foreign exchange or payments.

Thi is not exhaustive, as communities exist in regards to organization type, function (front office, back office, infrastructure, regulatory, etc), and so on. But any regulatory model should reflect that which it is regulating - and understand the community in which it is meant to both protect and when necessary prosecute.

Appendix II:

High Level Fraud:
By Anthony Stansfeld, Police Crime Commissioner, Thames Valley Police

Fraud is now costing the UK economy as much as the entire NHS. The annual figure for fraud given by the National Crime Agency is over £190Bn based on figures from three years ago. This is almost certainly an underestimate. The NHS in the same year cost £197Bn a year.

Little is done to combat major fraud. Less than 0.03% of the amount lost is spent on countering fraud. The Serious Fraud Office receives around £50m a year, Action Fraud, which has been shown to be largely unfit for purpose, receives £16m. Police Forces have neither the time, capacity, nor capability to take on fraud. When fraud cases are brought to their attention, they are either sent to Action Fraud, where mostly they disappear into an administrative hole never to be heard of again; or are classed as a civil matter. The few that are distributed back down to police forces are rarely investigated. Less than 2% of fraud is investigated properly, and only a fraction of that brought to justice.

PPI, LIBOR, and the extensive money laundering of the assets of major criminal enterprises, have resulted in banks being fined heavily. However, this penalty falls on the totally innocent shareholders of the banks. No senior bank executives are ever held responsible for these massive criminal frauds, and they continue to receive not only large pay packets, but also massive bonuses.

Even more serious has been the deliberate destruction of individuals and companies by banks to pillage their assets. There has been little effort or enthusiasm by the many regulatory authorities, notably the Bank of England's Prudential Regulatory Committee (PRC), the Serious Fraud Office (SFO) and the Financial Conduct Agency (FCA), to either stop these frauds or bring the perpetrators to justice. These major frauds, unlike Libor and PPI, were not skimming off the top. They have ruined thousands of companies, farmers, and families. A great number of jobs have been destroyed. Companies, homes, farms and possessions have been repossessed on forged documentation across the country. The damage to the UK economy has been massive.

In August 2019 the Treasury Select Committee asked the National Crime Agency (NCA) to look into the industrial scale forging of signatures by banks and the alteration of documentation. Twelve large files of evidence were given to the NCA. In spite of having a

responsibility for Serious Organised Crime, the files were immediately given to the FCA which has been aware of the problem for years. It was then passed to the SFO, who have been in possession of similar documentation for several months. It is now back with the NCA with no apparent investigation having been started. The ability of the Regulatory Authorities to pass the parcel between each other without anyone taking responsibility is a neat way to avoid action being taken. There are now 19 files of evidence with the NCA. As of now no investigation has moved forward further than a 'review' of the evidence.
The underlying problem is that senior white-collar crime is not seen by the establishment to be a real crime. A senior Metropolitan police fraud officer wrote to the Treasury Select Committee in 2017 stating that the executive boards of some of our most prominent banks were Serious Organised Crime (SOC) syndicates. His report was hastily buried. From everything I have seen, and which has become apparent over the last three years, he may Well have a point.

Stealing a million pounds through the front door of a bank will result in a police response. Steal a billion through the back door and nothing is done.

The HBOS Reading case involved a fraud approaching £1Bn. It cost Thames Valley Police £7m to bring to court. Those charged were found guilty, and 6 individuals received combined sentences of 48 years. No one at board level took responsibility. The FCA fined Lloyds Bank £45m for concealing the fraud, but yet again held no one responsible at board level. The fine was passed directly to the Treasury. In spite of the then Chancellor, Philip Hammond, being asked to reimburse TVP the cost of the case, he refused to do so. It is little wonder that Police forces, which rarely have either the capacity or capability to investigate high level fraud, are reluctant to take on fraud perpetrated through banks. It is costly to do so, and even if they recover massive sums of money, none reverts to the police force that has borne the cost.

An internal review into what had gone on in Lloyds, called the Turnbull Report, was written in 2013. It laid out in detail the consequences of the inaccurate, and possibly fraudulent, KPMG audits carried out on the HBOS accounts. These had overlooked massive holes in the bank balance sheet approaching £40Bn, and the concealment of the £1Bn fraud carried out in Reading. On the back of these audits, both HBOS and Lloyds had raised billions in Rights Issues on knowingly false accounts. KPMG were also the auditors of the Co-Op Bank and Carillion.

The senior partner of KPMG became Chairman of the FCA. It is interesting to note that the Chairman of the Financial Reporting Council (FRC), which is meant to monitor auditors, gave the KPMG audits of HBOS a clean bill of health. The Chairman of the FRC was in his previous job, Chairman of Lloyds.

The Turnbull Report was written by a senior Lloyd's accountant, Sally Masterton. It named both the companies and individuals involved in the frauds and the cover up. She was promptly made redundant with minimal compensation. The bank denied the report was authorised and did its best to denigrate its author. Both the Bank of England and the FCA received the report in early 2014. In spite of the evidence neither took action. Three years after Sally Masterton was sacked the bank had to admit her report was authorised and she was paid compensation. The failure of the FCA to protect Sally Masterton is regrettable, it took others to ensure the bank apologised to her and paid her compensation. Needless to say, it was accompanied by a draconian Non-Disclosure Agreement.

In 2017 it became apparent that the Turnbull Report had been concealed by the 3-man Executive Board of Lloyds from their own Chairman and non-executive directors for three years. The Chairman, Lord Blackwell, was sent a copy of the report in March 2017. He took no action in spite of it being clear that a number of fundamental company rules had been broken by his executive board. As far as can be ascertained he failed to pass on the report to the other non-executive directors for a further year. Anita Frew, the senior non-executive Director of Lloyds, was asked when the Chairman shared the report with the other non-executive Directors. It is a simple question she would not answer, and neither would the Company Secretary. It was not until the report was published through parliament that she and most of the other non-executive directors were made aware of the report.
Similar frauds to HBOS were also going on in Lloyds itself, RBS and Clydesdale. It is estimated that RBS alone took down around 16,000 companies. A proportion of these were not viable, a great number were, and had never defaulted on loans. The companies were pushed into the RBS Global Restructuring Group. This was meant to assist companies, not destroy them.

Its Chief Executive told the Treasury Select Committee it was not a profit centre. It made £billons pillaging companies. No one has been held to account for this. The head of RBS GRG became Chief Executive of Santander UK Bank. The FCA and the Bank of England stood back and did nothing.

The SFO is now in possession of both the Turnbull Report and detailed files on the use of forged documents and signatures that have been used to convince courts to bankrupt a vast number of individuals and repossess their homes. The Turnbull report has sat with the SFO for a year, and with the FCA and Bank of England for five years. Action by them is well overdue.

The evidence is clear. The files that cover the forged documents have been with the SFO for six months. Again, the evidence is clear. I trust it will not be covered up like so much else has been.

Similar frauds were perpetrated in both the US and Australia. In the US, the banks were fined £25Bn for the forging of documents and bankers gaoled. In Australia the government set up a Royal Commission. Its report is devastating, and the police are now taking action against the bankers and associates involved. In the UK nothing has been done. There would appear to have been a systematic cover up. The Bank of England, the FCA, the FRC and a number of other bodies have failed to hold the banks and accountancy companies to account. There is a revolving door between employment in these agencies and the major banks. It has been at the expense of thousands of small and medium size companies. The bailout of Lloyds and RBS by the Treasury merely compounded the loss to the UK economy.

Two major inquiries into Lloyds Bank have been commissioned. Sir Ros Cranston, a retired High Court Judge, has now reported on Lloyd's Bank treatment and compensation paid to victims of the HBOS Reading frauds. His conclusions are that Lloyd's treatment of those defrauded was 'neither fair nor reasonable'. The internal Lloyds scheme under a Professor Griggs is widely believed to have failed to properly compensate those small numbers of victims whose names came up in the court case. The others defrauded, whose cases were not brought up during the court case, have largely been ignored. It is worth mentioning that only a small part of the Reading fraud was prosecuted, probably less than a third of the overall fraud. This gave the bank the opportunity not to compensate the many others who had been defrauded. All those who have been compensated were made take it or leave it offers, accompanied by Non-Disclosure Agreements (NDAs).

The other inquiry is an internal Lloyd's inquiry headed by another senior Judge, Dame Linda Dobbs. This started in 2017 as a small inquiry into what had gone on within Lloyds over the HBOS case. It has now expanded into a major inquiry that will not report until this year.

It will have taken over 4 years and a large team of lawyers supporting Dame Linda, with two lead QCs, to get to the bottom of this. Every stone that is turned over expands the inquiry. The concern about this report is that most of those responsible will have departed the bank with large bonuses and pay offs before the report is released. Only part of the problem is being looked at by the inquiry. What went on in other branches of Lloyds is not part of the inquiry.

In the current economic climate, it is clearly necessary to support the banking system, but that does not mean that corrupt senior bankers should be supported. Ideally the Government should set up a full Public Judicial Inquiry into what went on in our banks. It should examine

how it can be prevented from ever happening again, why the regulatory authorities covered it up, how the victims should be compensated, and who should be prosecuted.
However, in the current circumstances the better option maybe is to have a number of smaller low-key inquiries that interlink. Those bankers clearly implicated should be asked to resign quietly, without bonuses and titles. Those that have the most senior positions should be told that unless they cooperate with the inquiries, they are liable to have a full criminal investigation launched into their activities.

There should be a clear direction that non-executive boards are there to hold the bank executives to account, not only for profitability, but also integrity. The current non- executive boards have knowingly failed in their duties, and should, in some banks, notably Lloyds, be replaced in their entirety.

It should become widely known in the City of London that fraud will be investigated, and prosecution will follow.

At the moment fraud is seen as a safe way to make money. In both the US and Australia, they have tackled this problem, and they now have a far less corrupt system than we do in the UK. There should also be a look into how the bankruptcy courts are being manipulated, and why the Land Registry and Insolvency Services have failed to guard the rights of property owners.

The behaviour of some of the most prominent legal companies who have acted on behalf of the banks should also be examined. Finally, the failure by some of the major trade bodies that are meant to regulate the behaviour of their members should be looked into. They would seem to have become more concerned about protecting their members rather than seeing they operate within the law.

The sorting out of flagrant frauds within the UK banking system, without damaging it yet further, will be a difficult balancing act. However it cannot be allowed to continue. The present economic situation has given banks the opportunities to go on behaving in the same way that they did after the crash in 2008. At least £500m should be used to set up regional police fraud units with the majority employed within them being forensic accountants. The money required should be taken from the annual fines levied by the FCA and ring fenced for this. The SFO should either be made fully independent of the Treasury or be subsumed by the NCA. The NCA should deal with the wide scale bank money laundering, and the international aspects of the frauds. This will need a proper fraud division to be set up within the NCA. The the current small team has no capability to take on international banking fraud. The governance of the NCA needs a radical rethink. It has clearly been complicit, with the City of London Police, in its failure to take on major fraud.

The UK needs a profitable banking system and it needs an honest one. The two appear not incompatible in certain situations. The UK cannot afford to gain a reputation for corrupt banking.

Appendix III:

Proposal to Introduce the Financial Regulator's Supervisory Council

Background

- The Independent Reviews into the Financial Conduct Authority's ('the FCA's') handling of The Connaught Income Fund Series 1 ('Connaught') and London Capital and Finance ('LCF') have made a number of recommendations for operational change, which the FCA has accepted;
- The extensive underperformance described in the Reviews has at its heart serious and longstanding problems with the regulator's culture and governance that raise grave questions about its ability to perform its overarching strategic objective, namely ensuring that the relevant markets operate well, and its three operational ones, namely protecting consumers, achieving integrity in the markets and promoting competition;
- There are also serious concerns about the capabilities of several members of the FCA's current senior leadership team, the performance of the teams led by whom came in for extensive criticism in the Reviews;
- Furthermore, there are already questions being asked about the judgement and leadership of recently-appointed Chief Executive Nikhil Rathi, for example around his seemingly naive appointment of Megan Butler as Executive Director for Transformation[11]. We consider this decision unwise given the extensive failings of teams under her previous leadership in both the cases reviewed and the stark contrast with the fact that her counterpart Jonathan Davidson, whose performance was also criticised, left the FCA prior to the publication of the two reports;
- It is also unclear[12] whether some or all LCF victims will be compensated by HM Treasury, in part or in whole, and there is as yet no proposed scheme for compensating Connaught victims, and indeed the FCA is falsely claiming[13] that they are not out of pocket;

[11] The role was not even advertised externally, and there were only two internal applicants (we suspect that Jonathan Davidson was the other)

[12] 'Taking into account the various channels through which people affected can seek compensation, the government will also set up a scheme to *assess* whether there is a justification for further one-off compensation payments *in certain circumstances* for *some LCF bondholders*.' [our italics] - John Glen

[13] 'The Fund entered liquidation in 2012, before we became the FCA, with aggregate principal losses estimated at *£79m*. Since then, investors have received over £80m, including over £58m of redress under the settlement we secured from Capita Financial Managers (CFM). Although the Fund failed 8 years ago and *investors have now received these funds*, the lessons of the failure are still highly relevant for us.' [my italics] - FCA response to independent review. In fact the principal losses were £104m, and in addition to

- Finally, there are a great many other cases in which consumers have lost significant sums of money through financial services fraud, misconduct and recklessness where they commonly feature levels of regulatory failure at least as acute as that identified in the Connaught and LCF reports[14]. There is an urgent need to accelerate the process of achieving transparency about the causation of those losses, to remedy them, and to implement thoroughgoing reforms;
- For these reasons, we believe that the response to the two Reports must go far beyond trusting the FCA's existing leadership to implement the specific and limited recommendations for operational improvement permissible under the Terms of Reference governing the reports' production. Rather, it is vital that uncomfortable truths must be confronted about the FCA's fitness for purpose and profound questions be answered about whether it should be abolished or reformed - and in the latter case, how this could be achieved in a manner materially different to the FSA/FCA rebrand exercise that took place in 2013.
- It seems to us that proposals for addressing the FCA's failings are likely to cluster around three options:
    - Abolition, followed by replacement with a gold-standard regulator or regulators, under different leadership and with greater accountability;
    - The introduction of a Royal or Parliamentary Commission, or some other Parliamentary or quasi-judicial review to review past failings and explore future options, perhaps based on learnings from the Australian Royal Commission;
    - Proposals for vastly improved governance arrangements, particularly those focused on making the existing regulator far more accountable to users of financial services, perhaps along the lines of the Financial Regulator Assessment Authority proposed for Australia
- The Transparency Task Force believes that this debate is essential, and looks forward to contributing to it. However we also recognise that reaching conclusions could take a long time, and the need to improve matters is pressing. For that reason we advocate pursuing the third, least radical option immediately, it being the one that can be implemented fastest, without the need for primary legislation;
- At the Transparency Task Force, we believe that transparency results in accountability, which in turn leads to change. Such reform is itself subject to transparent scrutiny,

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the £25m shortfall in capital returned, the investors have also suffered up to 12 years' loss of income and liquidity, the latter leading also to opportunity costs, and some have incurred significant time costs pursuing the matter

[14] These include, but are not limited to, Woodford, Lendy, Collateral, Funding Secure, Park First and German Property Group/Dolphin Trust. There are also outstanding cases affecting small businesses in which regulatory failure and/or collusion is alleged, such as the Interest Rate Hedging Product redress scheme and the HBoS Reading fraud, in which reports are expected to be published in 2021

creating a virtuous circle of continuous improvement. The key to fixing the FCA therefore begins and ends with transparency and accountability. Implementing governance reform quickly, while more profound changes are debated, is an asymmetric bet: if it works, the need for more radical changes will be forestalled; if it does not, the case for them will have been proven;

- To this end we propose a modest package of improvements to the FCA's governance structure, implementable in a short timeframe and at no net cost, following the introduction of minor, enabling secondary legislation. Indeed we believe it may be possible to make these changes without the need for legislation;
- These changes are achievable by transferring some of the responsibilities currently divided between the FCA, the Treasury and the Department for Business, Energy and Industrial Strategy to a new statutory body, the Financial Regulators' Supervisory Council ('FRSC'), which would be comprised of stakeholders who genuinely represent the interests of users of UK financial services;
- The aim of these changes is to improve transparency and make the FCA directly accountable to those who have at heart the best interests of those whom the regulator is intended to protect and serve

Proposal

- We advocate the introduction of a new statutory entity, provisionally named the Financial Regulator's Supervision Council ('FRSC'), whose role would be to play a central role in representing the interests of non-industry interests in the governance structure of the Financial Conduct Authority;
- The FRSC would have the following powers and responsibilities:
    - To appoint, to review annually the performance of and, where appropriate, to dismiss[15] the following:
        - Jointly with the Treasury[16], the Chair and Chief Executive of the FCA (currently sole responsibility of the Treasury);
        - The two Non-Executive Directors of the FCA currently appointed by the Department for Business, Energy and Industrial Strategy;
        - Members and Chair of the Financial Services Consumer Panel[17];

[15] respecting normal employment practices and contractual rights
[16] and subject to the approval of appointments by the Treasury Committee
[17] Currently, the Panel's membership comprises largely people from the financial services industry. According to the organisation's own website, 'Membership of the Financial Services Consumer Panel is constructed to represent the various sectors within which regulated financial businesses operate, often based on nominations made by trade associations', an apparent breach of the obligation placed on the

    - The Financial Regulators' Complaints Commissioner;
    - Such employees as the FRSC requires to perform its statutory role
- Where appropriate, to commission, review and oversee implementation by the FCA of recommendations of:
    - Periodic Reviews[18] of 'the economy, efficiency and effectiveness with which the FCA has used its resources in discharging its functions';
    - Periodic Reviews of the FCA's treatment of whistleblowers and its response to the evidence they provide;
    - Independent Reviews[19] of the FCA's conduct in circumstances in which there are reasonable grounds for believing that there has been material regulatory failure
- To establish operating guidelines for the operation of the Complaints Scheme[20] insofar as it relates to complaints about the FCA, and to monitor the effectiveness of the Scheme and of the FCA's responses to it;
- To act as a designated consumer body by order of the Treasury in submitting, where appropriate, super-complaints to the FCA[21] should it identify examples of market behaviour which it reasonably believes are operating against the interests of consumers;
- To publish white papers, consultation responses and other documents intended to contribute to debate about financial services regulation in the UK;
- Once a year, or additionally on request, to report to the Treasury on its view about the performance of the FCA and suitability of the regulatory environment, together with any recommendations for change
- Provide information and advice as required to the Treasury and Work and Pensions Committees, other Select Committees and All Party Parliamentary Groups as appropriate

FRSC membership, staffing and funding

FCA by Section 1Q (5) of Chapter 1 of Part 1A of the Financial Services Act 2012 ('the Act'), which requires that 'The FCA must secure that membership of the Consumer Panel is such as to give a fair degree of representation to those who are using, or are or may be contemplating using, services otherwise than in connection with businesses carried on by them'

[18] under Section 1S of Chapter 1 of Part 1A of Part 2.6 of the Act

[19] replacing the obligation on the FCA under Section 73 of Part 5 of the Act

[20] as described in Section 84 of the Act

[21] under Section 234C of the Financial Services and Markets Act 2000 ('FSMA')

- The FRSC's membership on formation would comprise seven people ('the Initial Members'): four ('the First Four Members') selected collectively by:
    - The Connaught creditors' committee;
    - The LCF creditors' committee;
    - The directors of Transparency Task Force
    - The directors of Whistleblowers UK
    - … and three selected by the First Four Members, based on open advertising of the vacancies and person specifications intended to fill in any gaps in the expertise and backgrounds of the above[22], while remaining wholly focused on the promotion of consumer rather than producer interests
- The Initial Members would all serve for an initial term of four years; thereafter, one would retire by the drawing of lots each year, the Members having first identified a successor ('Replacement Member'). Replacement Members would each serve for four years;
- The Initial Members would appoint a Chair shortly after they are appointed, who would serve for four years. The Members at that time would appoint a successor for the next four years who would serve a four-year term; this process would continue barring any resignation or decision by the FRSC to vary its policy;
- The FRSC would employ such people as it sees fit to enable it to perform its statutory functions;
- Members and employees would be subject to the Nolan principles and to terms and conditions of engagement that bar them from entering into arrangements (including employment or consultancy contracts) during and for an extended period following their service with the FRSC that could reasonably be considered to represent potential or actual conflicts of interest or inducements;
- The FRSC would be funded by a levy of 0.5 percent of the Annual Gross Income of the FCA[23] and would have the right to recover from the FCA the reasonable costs of commissioning Independent and Periodic Reviews of the latter's conduct and performance.

Benefits of this approach

- The FCA will remain an independent statutory body, but responsibility for ensuring that it performs satisfactorily and that consumer interests are foremost, currently

[22] For instance, their number should include people with experience of SME, wholesale and corporate banking and the financial markets
[23] ~£3.2m in 2019/20

fragmented, will be concentrated in a single body, creating the transparency and accountability that is currently lacking;

- Creating the FRSC will place at the heart of the governance of the FCA those with a genuine and demonstrable interest in ensuring that the regulator performs its statutory duties to a high standard, and in the best interests of users of financial services in the UK;
- The FCA's two key executives - Chair and Chief Executive - will be, in part, appointed and at risk of dismissal by a body that represents consumer, rather than producer, interests, while two of the organisation's Non-Executive Directors and the Financial Regulators' Complaints Commissioner, whose work relates largely to the actions and inactions of the FCA[24], would be wholly so;
- Nobody has a better understanding of the serious cultural and governance flaws that beset the FCA than those who have represented consumer interests in the Connaught and LCF cases prior to, during and following the publication of the Independent Reviews. They must be part of the solution, and this proposal makes that possible;
- Likewise, whistleblowers have played a central part in both cases, and their evidence (and their professional and emotional wellbeing) has been treated appallingly in these and many other financial services scandals. It is therefore right that Whistleblowers UK, as the leading independent organisation advocating for whistleblower rights in the UK, is able to nominate an Initial Member;
- The Transparency Task Force brings together many ethically-minded individuals that have a pro-consumer mindset; thought leaders from industry and academia as well as victims of misconduct and regulatory failure, across a wide range of cases. It is an international organisation that can bring to bear expertise from many other regulatory environments. Its involvement is critical;
- The First Four Members will bring on board subsequent members whose skills and experiences fill any gaps - for instance, in business-to-business financial services and financial markets;
- There is an ever-present risk that any governance arrangements for the FCA may become captured by industry interests, as has occurred with the Financial Services Consumer Panel[25]. The FRSC proposal avoids this risk by ensuring that the majority of the Initial Members are genuine representatives of consumer and whistleblower

[24] 74.5 percent in 2019/20

[25] Its website, as at 5 January 2021, states: 'Membership of the Financial Services Consumer Panel is constructed to *represent the various sectors within which regulated financial businesses operate*, often based on *nominations made by trade associations*.' [our italics]. Appointments are made by the FCA, which is under a statutory duty as a result of the Financial Services Act 2012 to 'secure that membership of the Consumer Panel is such as to give a fair degree of representation to those who are using, or are or may be contemplating using, services otherwise than in connection with businesses carried on by them.' We are concerned that it may be in breach of this requirement

interests, and by guaranteeing that all replacement Members are appointed by Members, rather than by the FCA, the Treasury or the industry;

- The cost of operating the FRSC will be only 0.5 percent of the annual income of the FCA - a small investment intended to ensure that far more value is obtained than currently from the 99.5 percent retained by the regulator;
- These changes do not require primary legislation; they can be achieved through a series of relatively minor amendments to the Act and to FSMA;
- This means that the proposed changes can be implemented swiftly, enabling long-overdue and much-needed positive change to take place in the near term while longer-term and more profound changes are considered. It is possible that the recommendations contained in this document, if implemented, may obviate the need to go further; but if not, they will at least ameliorate the situation materially in the meantime.

Appendix IV:

By Dr Andy Schmulow

University of Wollongong, Australia

[Please note that we believe the content below from Dr. Schmulow provides the basis of a very good solution for those that want better governance of our financial sector through greater regulatory transparency, scrutiny and accountability. Of course there would need to be adjustments made to the approach for it to work effectively for the UK market but it seems obvious to us that if we want better governance, this idea, or something like it needs to be embraced.

Note also that the content below is a straight copy/paste, we have not amended it in any way.]

……………………………………………………………….

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25 October 2018

Simon Daley
Solicitor Assisting
Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

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Dear Mr Daley

Re: Invitation to submit a forthcoming journal article analysing the Financial Regulator Assessment Board

Thank you for your invitation of 23 October, extended on the Commission's behalf, to make this submission. We have attached to this report the article that is currently 'forthcoming' in the *Federal Law Review*.

In order to further assist the Commission we have attempted to extract the main points from the article, and these appear below.

Should you wish to seek clarification or additional information, please do not hesitate to contact Dr Andy Schmulow at andys@uow.edu.au.

Yours faithfully

Andrew Schmulow Karen Fairweather John Tarrant

SUBMISSION TO THE ROYAL COMMISSION INTO MISCONDUCT IN THE BANKING, SUPERANNUATION AND FINANCIAL SERVICES INDUSTRY

Dr Andrew Schmulow, Senior Lecturer, School of Law, University of Wollongong

Dr Karen Fairweather Lecturer, Auckland Law School, University of Auckland

and

Professor John Tarrant, Professor, Law School, University of Western Australia

25 October 2018

I AUTHORS

1. Each of the authors currently occupies an academic position, and it is in that capacity that each author has contributed to this submission – Schmulow and Tarrant at Australian universities, Fairweather at a New Zealand university (but previously at Australian universities). The authors undertook this research as an independent scholarly enquiry, without any form of assistance, funding or resourcing, or to any other benefit which may give rise to a conflict of interest, outside of those facilities ordinarily extended to members of faculty relative to each author's respective position, and by their respective university employers.
2. Our intention is to contribute to the development of sound financial regulatory architecture in Australia, and it is upon this basis that this submission is made. The authors have been involved to varying degrees in this question, and related questions of consumer protection and regulation and regulatory theory, for the majority of their careers.

II BACKGROUND

3. The Federal government established a Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Banking Royal Commission) on 30 November 2017.[1]
4. The Banking Royal Commission has released its Interim Report dated 28 September 2018 (the Interim Report)[2], and invited public submissions.
5. Paragraph 5.2 of Chapter 8 of the Interim Report posed the question, 'Should there be annual reviews of the regulators' performance against their mandates?'[3] Our submission addresses that question.
6. Our submission is focused on the benefits of establishing a Financial Regulator Assessment Board (Assessment Board) to undertake annual reviews of overall regulator performance against their mandates. Such a Board was recommended by the Financial System Inquiry (FSI) in 2014, chaired by David Murray AO (Recommendation number 27 of the FSI Final Report).[4]

III HYPOTHESIS

7. Our submission is based almost entirely on our joint article, *forthcoming*, in the *Federal Law Review*.[5] The article is divided into two parts. The first conducts a deep theoretical treatment of regulatory capture, and demonstrates that many of the deficiencies identified by the Commission's Interim Report, and ventilated in testimony before the Commission, are explained by the extensive body of existing scholarship on regulatory capture. We provide examples from the Australian context. Some of the subtleties of capture we address (such as ideational or ideological capture) allow us to inform the reader of the nuances involved in constructing an effective and robust framework of regulatory oversight.
8. We alert the reader to the body of evidence indicating that while regulatory capture is a risk in the regulation of all industries, nowhere is it more prevalent than in the financial industry. Indeed, evidence suggests that financial regulators 'fall first, and fail hardest'. To this end we provide internationally comparative evidence.
9. With the opportunities for capture discussed and demonstrated, both in the range of opportunities and the subtleties of the temptations, we then conduct an internationally comparative, cross-jurisdictional analysis of one method to deter and prevent regulatory capture – a board of oversight (Financial Regulator Assessment Board (Assessment Board) in the Australian context) the purpose of which is to enhance regulator efficacy by acting as a check and a balance against capture. This analysis draws upon contributions such as those of Adams, writing in the late 1800s, who observed the manner in which the Railroad Commissions had been captured by regulatees.[6]
10. We present the work of other scholars who have made notable contributions to our understanding of how such a board of oversight could be envisaged, so as to address in its design and in its operation deterrence of capture, including the kind of leveraged capture which would include the capture of the board of oversight itself. This includes the work of McCraw[7], Breger *et al*[8], Pagliari[9], and others, on a 'Sunshine Commission', and Barth *et al*[10] on a 'Sentinel'.
11. To this end our research argues that it is as important to resolve what such a board would do, as it is to resolve what it should not do.
12. Our findings provide a solution with a high degree of granularity, based in part upon the findings of the FSI, and also upon comparative examples and theoretical scholarship, where those are aimed at addressing capture, and in particular the issue

of the capture of financial sector regulators. In addition our findings pay particular attention to enhancing regulator efficacy, and to ensuring independence, while avoiding the creation of overlap or gaps, confusion, or ‘turf battles’.

13. Our findings also address a further issue, that of the life-cycle of regulatory agencies – they begin with ‘determination and youthful exuberance [but] pass inexorably into middle-age and finally senescence’.[11]

IV MAJOR FINDINGS - REGULATORY CAPTURE

14. It is our recommendation that an Assessment Board be established in major part because of regulatory capture in the financial services sector.
15. Regulatory capture is ‘a process by which policy is directed away from the public interest and toward the interests of a regulated industry.’[12]
16. Regulatory capture encompasses both ‘legislative’ (or ‘statutory’) capture and ‘agency’ (or ‘administrative’) capture,[13] and may occur at any stage of the regulatory process. It may occur when the legislature considers whether to create a regulatory regime and the shape such a regime should take (the legislative phase), when a regulatory agency considers exercising its delegated rule-making powers (the rule-making phase), and at the stage of supervision and enforcement by that agency.
17. The financial regulation environment, in jurisdictions including Australia, exhibits several features that predispose it to regulatory capture. Despite the common perception of banks as wholly private institutions, they perform a number of important public functions, namely as vehicles of public finance, conveyer belts of monetary policy, and bailout agents for government. It is therefore unsurprising that a high degree of industry influence is evident.[14]
18. The complexity and technicality of many financial transactions inevitably places the public at a severe participatory disadvantage, vis-à-vis industry, in the policy formation and rule-making process.
19. The Interim Report highlighted failures in regulation by both ASIC and APRA.[15] In our view these failures can be partly explained by regulatory capture in Australia’s financial services industry.

V A REGULATOR FOR THE AUSTRALIAN FINANCIAL REGULATORS

20. Currently in Australia accountability mechanisms exist. For example, APRA, the financial system stability regulator, has a high degree of statutory independence,[16] but is to a degree answerable to the Treasurer.[17]
21. In addition, both APRA[18] and ASIC[19] are accountable to Federal Parliament by way of submission of Annual Reports, and by way of testimony before Parliamentary committees.[20]
22. Nonetheless these mechanisms have proved to be largely ineffectual.
23. In its final report, the Commonwealth government-constituted FSI proposed (at recommendation 27)[21] that the Federal government create a new Financial Regulator Assessment Board (the Assessment Board) to provide annual reports on the performance of both APRA and ASIC and the payment-system-regulation function of the Reserve Bank of Australia (RBA).[22]
24. The proposed Assessment Board would assess regulators against their mandates and priorities, listed in their Statements of Intent (SOIs).[23]
25. The purpose of such an Assessment Board would be to improve the regulator accountability framework.[24]Specifically aimed at addressing ASIC's poor performance, and strengthening its performance in the future, the FSI asserted that establishing an Assessment Board would 'help to ensure ASIC has the appropriate skills and culture to adopt a flexible risk-based approach to its future role. Its overall performance would also be subject to annual review by the [Assessment Board].'[25]
26. The FSI report envisaged that the government would receive annual, independent advice on regulator performance,[26] and that the reports would be made public.[27]
27. While the FSI noted that Parliament reviewed regulators' annual reports, parliamentary scrutiny was ad hoc and focused on particular issues or decisions. This, the FSI concluded, made effective monitoring of the regulators difficult, especially considering the complexity of the regulators' mandates.[28]
28. The FSI proposal did not call for the Assessment Board to be constituted as a separate agency, but it did propose a separate secretariat be provided by Treasury. This would keep the Assessment Board's secretariat at arm's length from the remainder of Treasury, which is important considering Treasury's policy role as a member of the Council of Financial Regulators (CFR).[29]
29. It was not intended that the Assessment Board would direct the regulators. Its role would be to submit reports to Government on how the regulators had used their powers and discretions.[30]

30. The Board would be comprised of between five and seven part-time members with industry and regulatory expertise, but to the exclusion of current employees of regulated entities.[31] Various other mechanisms would be employed to ensure that Board members were sufficiently skilled, objective, impartial, and unconflicted.
31. They would serve staggered, limited terms to ensure continuity, and to ensure that the membership is refreshed with sufficient regularity. Individuals who provide leadership in regulatory agencies over an extended period of time will quite naturally influence the way in which that Agency undertakes its role. Even the most vigilant and impartial regulator will possess certain cognitive biases. By refreshing the membership of the Board on a regular basis the cognitive biases of a given individual will not affect disproportionately the policies and the conduct of an agency.
32. In recommending the establishment of the Assessment Board, an Inspector-General model was rejected by the FSI, as it would have involved the creation of a new agency.[32] Moreover, one of the advantages of an Assessment Board over that of an Inspector-General was that, in the case of the latter, much reliance would be placed on one person, whereas an Assessment Board would include expertise across regulators.
33. The FSI also rejected a suggestion that the CFR be formally constituted as an oversight body, on the grounds that such a proposal would fundamentally change the regulatory system, weaken accountability, and interfere with the CFR's ability to facilitate cooperation between the regulators.[33]
34. The FSI concluded that 'creating a new Assessment Board to review regulator performance is the best way to address the gap it has identified in the current accountability framework' and that such an Assessment Board 'would facilitate improved scrutiny of regulator performance without creating new agencies or compromising existing accountability … not intended to reduce the independence of regulators in executing their statutory mandates'.[34]
35. Currently other, partial, examples of such boards of oversight include the Inspector General of Taxation in Australia, and to a limited degree, the Financial Policy Committee[35] in the United Kingdom. The latter body was established by legislation promulgated in April 2013,[36] and has binding authority over the agencies over which it has oversight. Its purpose is to look for the next 'bombshell' that may hit the financial system by identifying, monitoring, and acting to reduce systemic risks.[37]
36. The United States Government Accountability Office (GAO) serves as a further, limited, and partial example. While the GAO is an independent, professional agency

that evaluates the performance of government institutions, it is primarily focused on financial efficiencies.[38]

VI ADVANTAGES OF AN ASSESSMENT BOARD FOR THE AUSTRALIAN FINANCIAL SERVICES SECTOR

37. The benefits to Australia of the establishment of an Assessment Board are clear, and would include enhanced accountability, improvements in the regulator's culture, prevention of regulatory capture, and enhanced capacity to prevent financial crises.
38. A Board would test and probe prevailing orthodoxies, such as those alluded to in evidence before the FSRC.[39]
39. In the United States, Barth, Caprio and Levine advocated for an expert panel of oversight called a 'Sentinel' that would, acting on the public's behalf, provide informed, expert, and independent assessment of financial regulation.[40] Such an expert panel is similar to the Assessment Board that we propose, and our recommendations borrow heavily from the 'Sentinel' proposal.
40. Barth, Caprio and Levine's proposal envisaged (i) an authoritative institution, independent of short-term politics and independent of the financial services industry; (ii) with the power to demand and obtain information necessary for assessing and monitoring the regulators; (iii) with the multidisciplinary expertise necessary to process that information; (iv) with the prominence to deliver such assessments to the public and its elected representatives; and (v) in an on-going manner capable of affecting the open discussion of financial regulatory policies.[41]
41. They argue that each of these characteristics 'is necessary for improving the still seriously flawed financial regulatory institutions operating around the world today.'[42]
42. In Australia, the current accountability framework — Parliament and its committees — would benefit from the creation of an Assessment Board in a similar way, by being informed by independent and impartial reports, prepared by experts, into the state of regulation in the financial sector. Such an Assessment Board should have an unfettered power to gain access to any information it deemed necessary for evaluating the state of financial regulation, including the power to compel information from regulated entities.
43. In the process of holding the regulators accountable, the Assessment Board would be expected to inquire into the appropriateness of the methodologies employed by

ASIC and APRA, question conclusions and assumptions, and challenge prevailing orthodoxies.

44. Because financial crises are unpredictable, and therefore difficult to foresee, such an expert panel of review would assist ASIC and APRA to *foresee the unforeseeable.*

45. The Assessment Board would analyse the inter-connectedness of systemically important institutions, their role in the payments system, and the role of depositor protection that may not ordinarily enjoy the attention of the regulators.

46. If the regulator's role includes the prevention of financial crises, then any improvements to regulator efficacy that may flow from the establishment of a board of oversight would include enhancing Australia's capacity to prevent endogenous financial crises or avoid the contagion of exogenous crises.

47. Oversight from highly-experienced individuals, appointed for a fixed-term, and independent, would be able to provide recursive reviews that would continually measure regulators against their mandates, and in so doing, provide a more fixed benchmark against which to make that measurement.

VII RESPONSES TO CRITICISMS OF THE FRAB PROPOSAL

48. <u>The costs are unjustifiable</u>: Estimates of the costs of remediating the fees-for-no-service issue exceed $1 billion.[43]Estimates of the costs to the financial sector of addressing the issues that gave rise to the FSRC, as well as the total costs of remediation, exceed $6 billion.[44] The costs of rescuing a failed bank can be multiples greater still; the costs of a financial crisis orders of magnitude greater.

49. <u>Rejected by the ASIC Capability Review</u>: The ASIC Capability Review states: "there is no need for 'another regulator to regulate the regulators'."[45] The Capability Review argues that the solution to ASIC's performance is to be found in better use of an existing sound governance structure.[46] While there is no doubt that governance structures that are better utilised will create better outcomes, we argue that this somewhat misses the point. Determining whether, from one period to the next, governance structures are being adequately utilised calls for independent, skilled, objective, arms-length analysis. This analysis should be afforded additional distance from the regulatees, in order to address the problem of capture – one that is particularly acute in this industry.

    49.1. Moreover the Capability Review provides a somewhat superficial gloss on the issue of an Assessment Board, without addressing the problems of capture. Nor does the Review address the theoretical scholarship that demonstrates that the financial sector poses additional challenges to regulators, as compared to regulators of other industries. Indeed the Capability Review only mentions an FRAB twice; the second time it does so, it incorrectly describes the acronym FRAB as ‘Financial Reporting Advisory Board’.[47]

49.2. The Capability Review findings were provided three years ago. Evidence provided to the FSRC and the findings contained in the Interim Report would suggest that despite the recommendation that ASIC address the utilisation of sound governance structures, those reforms have either not been progressed, or have not yielded the desired results.

50. The solution to ineffective regulators it to provide them with more power: We argue that additional powers ceded to regulators will be of no benefit where the problem is an unwillingness to enforce even existing laws. This is reflected in the FSRC’s Interim Report.[48]

51. The proposal for an FRAB was rendered obsolete by the establishment of the Financial Sector Advisory Council: This Council was constituted to ‘provide the Government with advice on policies that will maintain an efficient, competitive and dynamic financial sector, consistent with the objectives of fairness, financial stability and prudence.’[49] The Council was comprised exclusively of current senior leaders from the regulated entities, and served as a government-funded industry lobbyist. In March 2018 it was scrapped.[50]

VIII CONCLUSION

52. Accordingly, the introduction of an Assessment Board in Australia would serve as a timely and highly effective adjunct to the current Australian Twin Peaks financial regulatory architecture comprising APRA and ASIC.

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[2] "Interim Report," ed. Commonwealth of Australia (Canberra, ACT: Royal Commission, 2018).
[3] Ibid., 299.
[4] Financial System Inquiry, "Financial System Inquiry Final Report," ed. The Treasury of the Australian Government (Canberra, ACT: Commonwealth Government of Australia, 2014)., 239.
[5] Schmulow A., K. Fairweather and J. Tarrant (2019) *Federal Law Review* 47(1), start page unknown.
[6] Adams, Jr., Charles Francis, "Boston," 106, no. 218 (1868).
[7] Thomas K. McCraw, *Prophets of Regulation: Charles Francis Adams; Louis D. Brandeis; James M. Landis; Alfred E. Kahn* (Cambridge MASS: Harvard University Press, 1986).
[8] Marshall J. Breger and Gary J. Edles, *Independent Agencies in the United States: Law, Structure, and Politics* (Oxford, UK: Oxford University Press, 2015).
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[10] James R. Barth, Gerard Caprio, and Ross Levine, "Making the Guardians of Finance Work for Us," in *Guardians of Finance: Making Regulators Work for Us*(Cambridge, MASS: MIT Press, 2012).
[11] McCraw., 44.
[12] Michael E Levine, 'Regulatory Capture' in Peter Newman (ed), *The New Palgrave Dictionary of Economics and the Law* (Palgrave McMillan, 1998) 267, 267.
[13] See Daniel Carpenter, 'Detecting and Measuring Capture' in Daniel Carpenter and David A Moss (eds), *Preventing Regulatory Capture: Special Interest Influence and How to Limit It* (Cambridge University Press, 2014) 57, 59–60.
[14] See Lawrence G Baxter, 'Capture Nuances in Financial Regulation' (2012) 47 *Wake Forrest Law Review* 537, 551-7.
[15] Royal Commission into Misconduct in the Banking. 269ff.
[16] *Australian Prudential Regulation Authority Act 1998* (Cth) s 11.
[17] Ibid ss 12(4)–(5).
[18] Ibid s 59.
[19] *Australian Securities and Investments Commission Act 2001* (Cth) s 136.
[20] See for eg: Coleman, David, Chair, et al., "Review of the Four Major Banks (First Report)," in *Review of the Four Major Banks*, ed. House of Representatives Committees, Standing Committee on Economics (Canberra, ACT: Parliament of the Commonwealth of Australia, 2016).
[21] Financial System Inquiry, *Financial System Inquiry Final Report*, Commonwealth Government of Australia (2014), 239. Recommendation 27 states 'Create a new Financial

Regulator Assessment Board to advise Government annually on how financial regulators have implemented their mandates. Provide clearer guidance to regulators in Statements of Expectation and increase the use of performance indicators for regulator performance'.

[22] Ibid.

[23] Ibid.

[24] Ibid 235.

[25] Ibid 237.

[26] Ibid 240.

[27] Ibid 239.

[28] Ibid 241.

[29] Ibid.

[30] Ibid.

[31] Ibid 239.

[32] Ibid 243.

[33] Ibid 243–4.

[34] Ibid 244.

[35] Financial Policy Committee, *Financial Policy Committee* (6 September 2018) Bank of England <https://www.bankofengland.co.uk/financial-stability>.

[36] *Financial Services Act 2012* (UK).

[37] Jill Treanor, *Farewell to the FSA—and the bleak legacy of the light-touch regulator* (24 March 2018) The Guardian <http://www.theguardian.com/business/2013/mar/24/farewell-fsa-bleak-legacy-light-touch-regulator>.

[38] US Government Accountability Office, "Overview," US Government Accountability Office, https://www.gao.gov/about/.

[39] See for example: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, "Module 5: Superannuation Closing Submissions," in *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Melbourne, VIC24 August, 2018). § 697, 699.2, 699.3, 701, 702.

[40] James R Barth, Gerard Caprio and Ross Levine, *Guardians of Finance: Making Regulators Work for Us* (MIT Press, 2012) 203-232.

[41] Barth, Caprio, and Levine., 204.

[42] Ibid. 204.

[43] Sue Lannin, "Banking Royal Commission: Banks and Amp Face Criminal Charges and $1b Bill in Fee-for-No-Service Scandal," Australian Broadcasting Corporation, https://www.abc.net.au/news/2018-08-17/apra-under-fire-for-failing-to-police-superannuation-industry/10129612.

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[45] Karen Chester, Mark Gray, and David Galbally AM QC, "Fit for the Future. A Capability Review of the Australian Securities and Investments Commission," in *Capability Review of the Australian Securities and Investments Commission (ASIC)* (Canberra, ACT2015). 17.
[46] Ibid. 6ff.
[47] Ibid. 26.
[48] Royal Commission into Misconduct in the Banking. xx.
[49] Australian Financial Centre Forum, "The Financial Sector Advisory Council," ed. The Treasury of the Australian Government (Canberra, ACT: Commonwealth Government of Australia).
[50] Richard Gluyas, "Turnbull Suspends Finance Council," *The Australian*, 23 May 2017 at 12:00 AM.

Appendix V:

Lessons still to be Learned from the Regulatory Lacunas relating to IRHP cases

It is well documented that the UK has a serious problem with fraud and is failing to curtail fraud by corporates, banking, public bodies and organised crime. Whether money laundering, financial products mis-selling, consumer credit exploitation, accounting fraud, banks forging signatures on documents put before the courts, etc; it is clear that the UK is fast losing the reputation it once had for providing a well-regulated financial and professional sector.

We seem to have extensive window dressing and multiple bodies - but little serious action taken in the UK against fraud in the UK. The Serious Fraud Office, Financial Conduct Authority, the National Economic Crime Centre and so on have dismal records. Fraud is "falling between the stools" of the many different bodies tasked (at least in part) to thwart fraud.

To bring these points “to life” we will now focus on the hard-earned experience by one member of our community:

His experience has shown that trying to bring criminality and fraud by a major bank to the attention of the Financial Conduct Authority (and the Financial Services Authority before it), the Financial Ombudsman Service, the Serious Fraud Office and the Bank in question has proven to be highly problematic.

We include this account of that experience in our response to demonstrate how flawed the implementation of the rules are by regulators.

In regards of evidence/allegations of Fraud – this is also relevant to the conduct of commercial banking relationship managers (invariably non authorised / approved / properly qualified individuals) in relation to their Small and Medium Enterprise (SME) business / retail customers and – introducing, inducing, engaging, advising upon and arranging regulated Interest Rate Hedging Products (IRHP) and the associated (and fully regulated) margin credit facilities. This is often perpetrated by way of a "cold call.”

For a regional manager of a bank to carry out any of the above activities (irrespective of whether or not the customer enters into the IRHP or Tailored Business Loan) constitutes a criminal offences under Sections 19 and 21 FSMA 2000 – and very likely qualify under all three classifications of fraud identified within The Fraud Act 2006.

When the customer makes the allegations and provides evidence of such criminal and fraudulent activities, the has FCA incorrectly refused to properly engage and instead redirects the SME to the Serious Fraud Office (SFO) - which is ultimately controlled by Treasury - or Action Fraud (controlled by City of London Police) and/or National Fraud Intelligence Bureau (also controlled by the City of London Police).

The SFO / Action Fraud / City of London Police explain to the SME that it is a matter for the FCA and/or they report the customers allegations / evidence (back) to the FCA. We are highly troubled to learn of accounts where t*he FCA then dissuades those agencies from taking the investigation any further.*
There is clearly a direct correlation between this conflicted relationship / approach and less than 3% of financial fraud being successfully investigated / prosecuted. We do not believe this is a result of negligence or oversight.

We understand that there are multiple Memoranda of Understanding between the FCA and other regulators such as the Prudential Regulatory Authority (PRA) and the Solicitors Regulatory Authority (STRA); and also between the FCA and the financial crime and fraud investigation agencies.

We also understand from regulatory experts, that it is in fact well within the perimeter of the FCA's remit to actively investigate and prosecute fraud and criminal conduct by bank staff, especially in relation to non authorised/approved persons engaging in regulated investment activities.

During the course of taking part in a regulatory review – the FCA mis-selling of Interest Rate Hedging Products Review Scheme (2012-2017) one of our members issued allegations and extensive documentary evidence of the above criminal and fraudulent activities.

Our member reports that he was given the runaround set out above and he was also informed in writing by the head of HSBC's Past Business Review Team that the FCA Scheme would not consider allegations or evidence of criminality or fraud.

On that basis it seems clear that the FCA did not not act properly upon reports of criminality and fraud – which are entirely relevant to its Supervisory obligations.

Furthermore, our understanding is that the FCA has also actively worked with the banks to design a scheme that deliberately excludes consideration of extremely relevant and critical information.

We believe that the public need financial fraud properly investigated and effectively dealt with, funded from the public purse. Legal remedies are unaffordable for the majority of ordinary people on average incomes who have been defrauded of life savings, pension pots, etc.

Appendix VI:

Are there Conflicts of Interest at the City of London Police?

The UK has 42 Police Forces that report to the Home Secretary and 1 that reports to the City of London Corporation (COLC), that is the City of London Police (COLP) which has control of the fraud remit nationally.

Is that what parliament has intended?

The City has approximately 9,000 residents with over 5,000 of those being corporations/businesses and of course all of the UK banks and most foreign banks are registered in the Square Mile. Circa 350,000 people are employed there and circa 90% of the residents and workers are involved in banking/finance.

The COLP report into the COLC and until recently the Chair of the Committee that oversees them was an investment banker who represents the Bishopgate Ward who is a Lieutenant of the City.

With the City being its own municipal democracy and not under the charge of Parliament, one does wonder if a private Police Force essentially looking after and reporting into bankers are the right entity to be in charge of white collar fraud nationally.

Perhaps there is scope for conflicts of interest?

Perhaps there is scope for regulatory capture?

Perhaps there is scope to use a computer algorithm to “determine”most frauds to be non-criminal? - according to this article, it would seem so:

Computer says no to police action in cyberfraud cases below £100k | News | The Times

It’s also interesting that this set up began in 2012 just after the most prolific 5 years of bank theft, asset stripping and fraud via swaps, GRG, HBOS Reading etc. and just before these fraudulent activities and thefts were coined to be “mis-selling” rather than fraud; and thereby able to be dealt with by voluntary reviews, by the actual banks involved. A coincidence perhaps?

The budget to run Action Fraud and the National Fraud Intelligence Bureau (NFIB) is only £11m per annum, circa 0.007% of the estimated loss to financial fraud in the UK.

To help them the NFIB second in help from other places and firms such as the FCA, SRA and magic circle firms…

Is there any wonder no single bank director has been successfully criminally prosecuted since the credit crunch?

Is there any wonder that there are widespread concerns about the overall integrity of our regulatory framework?

Appendix VII:

Conflict of interests and 'Time'
- Enemies of, and barriers to, objective resolution and remedy

There are multiple issues pursuant to banking and financial services, multiple facets, multiple threads and significant overlap of multiple sectors and multiple regulators. This creates many opportunities to 'pass the buck', all of which leads to a perception of complexity, that is compounded by the firms, the regulators and particularly the law firms that defend them, with the net result being no responsibility taken, no accountability defined, and no objective review, resolution and remedy.

We refer to the Project Lord Turnbull report. It exposes multiple offences over many years by multiple firms, covered by multiple regulators, and yet nobody was held accountable, until Thames Valley Police acted.

However, focusing on the commonality enables us to simplify and introduce straightforward solutions that cover a vast number of issues.

The 'revolving door' and conflict is the commonality that exists at every turn. Regulators that are 'funded' by the very firms they are supposed to regulate. Regulators populated by former professionals from the sector, many of whom might be implicated or exposed by complaints and evidence today in respect of conduct they were involved in historically. Regulators potentially having to investigate or review former colleagues. Regulators that are potentially exposed for having failed to uncover that which was going on industry wide, or for having known about that which was going on industry wide but had chosen to ignore previously. Namely LIBOR, REPO and FX manipulation. All of which was going on industry wide, all of which was known about at the highest levels within the banks and within the regulators, and all of whom sought to conceal and deny.

The conflict even extends to law enforcement. It is a very well trodden career path now that police officers with experience in fraud and economic crime and that serve their 30-40 years and retire on full pension, can land lucrative jobs within the investigation departments of banks, insurance companies or other large financial firms.

Indeed, all banks have retired police officers within these departments. Will an officer be prepared to investigate or help prosecute a potential future employer or former colleague now working within that bank? Will the former police officers within the banks be tempted to use their contacts to exert 'influence'? Jes Staley, the CEO of Barclays when attempting to hunt down a whistleblower, persuaded a Barclays employee to use their law enforcement connections to facilitate this hunt.

It should be stressed that the existence of a conflict of interest does not guarantee or suggest wrongdoing or criminality has occurred. However, the term exists, as do countless laws and codes that seek to prevent it, in recognition of the opportunity for such wrongdoing or criminality that it presents.

Once even a minor concealment, a small indiscretion, a white lie or misleading or false representation has occurred, or a case 'buried' to deny a claimant, or to avoid exposure or embarrassment, it creates a precedent. A precedent that serves as an infection or a virus that is not just limited to the case in question but that will now extend to any such future case with the same or similar issues. The precedent represents a liability.

A new complaint or case that is brought forward is now no longer subject to review on its merits, its evidence and its arguments. Instead it is subject to consideration and review against the infected precedent. This results in inconceivable conduct and decisions, that in turn become further precedents that need to be upheld in the future.

The facts bear this out. The HBOS Reading fraud as demonstrated by the Project Lord Turnbull report and the FSA Final Notice to Lloyds in 2012, was actually detected quite early. However, each line of defence was deemed to have failed. Quite simply, nobody wanted to take responsibility or admit that it had happened or was happening.

Likewise FX collusion, antitrust offences and benchmark manipulation was brought to the attention of senior managers, Boards, regulators and the Bank of England as far back as 2009. However, it was not until Bloomberg broke the story in the Summer of 2013 that banks, Boards and regulators did anything. And when they did act, banks and regulators sought to minimize liability and conceal the extent of the wrongdoing. The FCA punished just six banks for FX wrongdoing.

Conflict exists in every regulatory corner, be it the firm's internal compliance or organisational structure, or at every level within the hierarchy of oversight.

There needs to be a truly independent body at the pinnacle of this financial services hierarchy, with ultimate authority and oversight, and free from conflict or political interest, and one that can and will engage across sectors where there is overlap.

The other common enemy is time.

In financial markets when you purchase a derivative for speculative purposes, the value of it is measured by a number of variables. However, a constant variable is ’time decay’ i.e. with every day that passes, the derivative that you own is one day closer to expiry or maturity, the date on which the product will expire and it, and the opportunity it affords you, will no longer exist.

In financial services and criminality the same time decay exists. For example you only have 6 months from receiving the final response from your bank to escalate your complaint to the Financial Ombudsman Service, or you have six years to file a claim in civil proceedings. Or a whistleblower must be able to show that they suffered a detriment within three months of the making of their protected disclosure etc.

In addition, time comes at a cost to the victims who do not have the financial resources of the banks and firms for long and protracted litigation, where every phrase or comma will be contested so as to extend the process.

The clock is ticking from day one, and a victim's opportunity and hopes ‘decay’, and their costs increase with every passing day.

The SFO, FCA and police forces require time to investigate, and it is evidence that the FCA will take extraordinary lengths of time to do so, and needlessly so. Likewise banks and their lawyers will conceal, obfuscate and deny and protract proceedings, and hope to do so until time barring occurs.

ECU Group vs HSBC is a rare example that relates to FX trades executed in 2006. ECU Group made a complaint and HSBC in their response denied the complaint altogether. And that was that, or so HSBC thought. However, in 2017 evidence emerged in the trial of a senior HSBC FX trader that suggested HSBC had lied or concealed evidence when denying the complaint. ECU Group applied to pursue their claim relating to these 2006 trades and seek PAD (Pre-Action Disclosure). They were successful and the Judge acknowledged that in such cases the victim is handicapped by the fact that they have little or none of the evidence, where the accused party has all of the evidence that exists that would be sufficient to bring or prove a complaint or claim.

This is true of almost every business forced into administration by a bank. Not only does the owner lose their business, they also lose any right to access information, request information or even bring a claim on behalf of that business. That rests with the appointed administrator, and that is often the same insolvency firm that 'assisted' the bank in their management of this business prior to forcing its insolvency. They are not likely to bring a claim against themselves.

There must be the ability to 'stop the clock' so to speak. If the banks and firms know that they cannot use their substantial resources and leverage costs or time, this will take a large stride towards levelling the playing field.

End.

E & OE