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Wheatley's new shoes

In his recent speech to the British Bankers' Association, chief executive of the incipient Financial Conduct Authority Martin Wheatley contended that we all need to walk in the footsteps of financial services customers. Sounds good? ***Julian Sampson*** *has concerns.*

As the parliamentary process of the Financial Services Bill grinds out its course, we all try to interpret the smoke signals arising from the new regulator, and what they mean for how it will work in practice. There has been no shortage of high-level 'think pieces' on strategy, priorities and the like but, among all these, Martin Wheatley's speech to the British Bankers Association on 25 January stands out.

Martin Wheatley counts. As chief executive designate of the nascent Financial Conduct Authority, the buck stops with him for all conduct issues for the vast majority of retail customer-facing firms. As a career regulator, he brings to his new role a perspective forged in roles as CEO of Hong Kong's Securities and Futures Commission, deputy chief executive of the London Stock Exchange Group plc and member of the FSA's Listing Authority Advisory Committee. So what he says matters more than most of the material issued on this subject by the FSA.

And what he has said is concerning. To mis-quote his predecessor and current boss, Hector Sants, people should be very frightened of the FCA – but not for the reasons that either of them would want. Martin Wheatley's speech gives every indication that the FCA is about to adopt a regulatory posture that is in the first place founded on false premises, but, more importantly, establishes a product intervention regime that cannot achieve its ends and elevates the principle of 'the regulator knows best' to new heights.

Martin Wheatley posits the hypothesis that orthodoxies have failed: specifically the beliefs that "people make rational decisions when given sufficient information; that markets are self-correcting organisms and… that if you oversee the distribution channels… the right products get to the right people".

As evidence of such failures, he cites a number of examples. As proof of irrationality, he contends that people "bought products they did not understand… assumed the future would always be like the past… and allowed others to do the homework…"

Are any of these behaviours truly "irrational"? How much of what we buy – in any sphere – do we really understand? To use a parallel example, none of us ever understand the workings of any of the electronic devices we buy. We understand that we think we have a need for them and understand what they do, but how they do it – their inner workings – remains a mystery. We're happy for that to remain the case. And in spite of our not knowing, nobody is going to stop us from buying them. And rightly so.

Financial services consumers are in fact making a rational response. They know that they have a problem: for example, they know that they need to make additional provision for retirement. The detail of how this is to be achieved, they entrust to a professional. That first insight is the important one. Much of the following detail they don't need to understand. That is not an irrational response.

And how 'irrational' is it to believe that the future will be like the past? While a trend shows every sign of continuing, it is rational to follow it. You don't need to be Confucius to know both that the future is indeed uncertain and that in spite of current trends having persisted, they may change. In spite of this, the best guide to the future is still, generally, the past. It is not irrational to follow trends. It is much more difficult and much more risky to seek to spot the turning points in trends and to take a contrarian position. Advice to that effect would only be suitable for those not risk averse.

As evidence of 'irrationality', Wheatley cites "allowing others to do the homework". Presumably, he thinks that we should not believe everything we're told. Now Wheatley himself would, I'm sure, pass both qualitative and quantitative tests with flying colours and be happy to be categorised as an elective professional. But as for the rest of us – how much of the professional advice that we receive in any sphere do we truly understand?

Is it 'irrational' to trust that advice? How many patients at their GP's surgeries (let alone those undergoing more complex procedures) ever understand the detail of those procedures and their effects? And those decisions are generally far more important than which fund to switch to.

Wheatley says the policy that "if you oversee the distribution channels… the right products get to the right people" has failed and gives the example of Payment Protection Insurance (PPI). There were clearly failures in relation to this product and in the specific procedures of specific firms. But these have to be seen against the wider context of the vast majority of other products and other firms that have delivered and continue to deliver satisfactory outcomes to consumers.

In that light, PPI, bad complaints handling, etc, are aberrant. If this were not the case and such poor products and business practices were the norm, the UK financial services industry would not continue to manage the funds of many individuals successfully, picking up the slack where government cannot provide.

Indeed, throughout his speech, Wheatley makes much use of specific market and regulatory failures to make his own general presumptions and prescriptions. The headlines are lurid: "inappropriate advice given to elderly customers… banks routinely rejecting complaints (and)… building societies transferring customers in retirement… out of deposit accounts into products that put their income and capital at risk". He selectively comments on financial services, focusing only on highlights (or lowlights) and making general prescriptions on that basis. I doubt that his compliance officer would allow him to use such an approach in a financial promotion. It lacks balance, and is hardly fair, clear and not misleading.

But given Wheatley's diagnosis, what is his prescription? What new approach will the FCA take to remedy these manifest and self-evident ills? Says he: "We all [including the FCA] have to walk in the footsteps of your customers."

For firms, there should be nothing new in this. Good firms have always 'walked in their customer's footsteps', just as they've always treated customers fairly – that's why they're still in business. And this should be the case irrespective of the size of the firm.

But if Wheatley's prescription is to be followed, the least it foreshadows is another change to the nature of FCA supervision. The supervision team's visit to the firm will become less important. More germane will be the mystery shopping trip and customer interviews, where the FCA will seek to 'join the dots' and confirm that "what your senior management commit to [is] consistent with the customer experience in reality". The FCA will have 'specialist teams' ready to do this.

But to a great extent, large firms already use such techniques themselves. They will have nothing to fear from this. And the FSA has been talking about using mystery shopping techniques at least since Sants' 'be afraid' speech of March 2009.

So what's new here? There are a few clues in the small print. Wheatley illustrates his case with the example of a fictional customer at three key stages of his life: opening a bank account, taking out a mortgage, and saving and investing for retirement. And at each of these stages, Wheatley knows what they want. "Customer expectations are pretty straightforward," he assures. "They want" this, "they expect" that, "they don't want" the other. This applies throughout the life-cycle.

Let's be clear – Wheatley is not setting out detailed product definitions for each of these lifecycle stages. He says that you should treat your customer as "an actual customer with real needs… we should all be working for the consumer". Of course! We should all do that. So, again, what's new?

What's new is this – while it may be fine for the FCA to "walk in the footsteps of your customers", the danger is that what the FCA will do is look at those footsteps and rather than follow them, decide that they show the customer – whether advised or not – is heading in the wrong direction. What the FCA putting itself in customers' footsteps assumes is that the FCA knows better than the adviser – or, more significantly, the customer – what the customer in fact needs.

Evidence of this is in what Wheatley says about product intervention. Again, much of what he says on product design is uncontroversial. We should all, when developing new products, follow a four-step process of targeting, testing, approving and monitoring. This will come as no surprise to all good producer companies. But for Wheatley this is not enough. There will be some products that are so inherently unsuitable that the FCA should be able to ban them without consultation for 12 months.

Of course, there is a case to be made for the FCA having robust powers to intervene in product development. The public needs to be protected. Just as no new medicine may be released for sale without it having been approved by the National Institute for Health and Clinical Excellence, so the FCA could pre-approve new financial products for sale to the general public. But it has long been stated that the FCA does not wish to 'pre-clear' products prior to release. So how is the FCA to hear about such toxic products in the first place? Clearly not by waiting for the FOS to tell them – that, they say, is too late. So how? Acting on 'information received'? And, more importantly, as the Treasury Select Committee has said in its January report on the FCA, "the case has not been made that the FCA will necessarily understand a new product better than a firm."

But the momentum to intervene grows. And behind it must lay an assumption that the FCA will know better than the firm – or, at worst, better than the customer themselves – what is good for that customer.

Wheatley would protest not. He does not wish to "bail people out of their poor decision-making". This is not to be a "zero-failure regime" and "investors are not [to be] completely absolved of the responsibility for their own decisions".

That's fine. But hold on – practically without pausing for breath, he goes on to say that, "We [one presumes, the FCA] have to realise that consumers aren't always in a position to take responsibility, because of their lack of financial knowledge and because we [again, one presumes the FCA] have to take a reasonable approach to what a normal person can understand about complicated products and risks."

So there we have it. The FCA stands ready to tell you – and your customers – what they really want and need. Never mind that you've explained it to them. The FCA will come along and say to that customer, "I'm going to walk in your footsteps. And what you really need is not what you or your adviser thinks, but what I think." This will absolve the customer from the responsibility of their own decision-making and place the firm in the invidious position where it cannot reach an agreement with a customer without the risk of it being second-guessed and unpicked after the event by the FCA.

But surely I'm worrying unnecessarily! Wheatley assures us that this whole financial advice thing is, in fact, easy. "Customer expectations are pretty straightforward," he says of banking. Mortgages? "It is now obvious that the [housing] market in the years leading up to the crisis was unsustainable." Savings and investment? All you need to do is "look at their personal circumstances, what their goals and aspirations are, and how much they're prepared to risk and then come up with something that is appropriate for them." And that, he says, is a "simple thing".

What a relief! I'll tell that to all those folk writing their exams, gaining experience, completing CPD. However, in reality, it's anything but simple. As Wheatley knows, those who give this advice have qualified by means of many exams and many years of experience. They would demur from the presumption that this was "simple" – as would the FSA itself.

A better solution would be for the FCA to grasp the nettle of product intervention by taking on the pre-clearance role, say, for products designed for retail customers. Then they would be assured – as would the public – that the product did what it said on the tin. Advisers could then be allowed to exercise their judgement as to what was in the client's best interests, given their circumstances.

Sadly, that's not on offer. If this speech is anything to go by, the prospects for the FCA are no better than they were for its predecessor. If this is where Martin Wheatley's footsteps are leading him, we should all be disappointed – and concerned.

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