The Financial Services Authority consults on when and how the Financial Conduct Authority may make temporary product intervention rules

The Financial Services Authority ("FSA") has published a consultation paper on when and how the Financial Conduct Authority ("FCA") may make temporary product intervention rules.

In summary:

> the FCA will make temporary product rules to advance its objectives, namely, consumer protection, competition and market integrity;

> the ability to make temporary product intervention rules will be an important part of the FCA's early intervention tool kit, it also confirms that the FCA does not intend to make such rules on a regular basis;

> temporary product intervention rules can be made without prior consultation – but the FCA will only make them in cases of serious concern where to delay action would jeopardise the FCA's effectiveness in delivering on its consumer protection objective and/or produce a significant redress bill for the industry – this is most likely to be market wide issues that arise akin to situations such as the payment protection insurance issues of previous years;

> the paper does provide some practical examples of when the power might be used, e.g. products where there is a significant incentive for inappropriate or indiscriminate targeting of consumers;

> the FCA may decide to incorporate unenforceability provisions in any temporary product intervention rules it makes, such that any agreements entered into after the rules are introduced and in contravention of the rules are unenforceable;

> the rules will state their duration, and upon expiry will lapse automatically, and rules will be published on the FCA website;

> products developed abroad but sold by intermediaries in the UK may be subject to temporary product intervention rules.

Contents

Background .................. 2
The making of temporary product intervention rules ........................................ 2
Practical examples of when temporary product intervention rules may be used......................... 3
Transparency of temporary product intervention rules ............. 3
Unenforceability provisions ...................... 4
Extra-territorial application of temporary product rules............. 4
What next ...................... 4
Background

As part of the drive to make the FCA more interventionist and with a lower risk tolerance than the FSA, the Financial Services Bill (“FS Bill”) confers on the FCA the power to make temporary product intervention rules. This proposed power has attracted a considerable amount of adverse comment from the industry, not least because the power may be exercised and rules made without any prior period of consultation, as would be usual. This is justified where the FCA considers it “necessary or expedient ...for the purpose of advancing the consumer protection objective or the competition objective or, [if an order from the Treasury is provided,] the [market] integrity objective”.

The rules can only be made without consultation for up to 12 months, and may not be renewed, hence the name temporary product intervention rules. The FCA is required under the FS Bill to issue a draft statement of policy with respect to the making of temporary product intervention rules, and to invite consultation on the draft. The statement of policy is intended to set out what the FCA’s policy will be, and the process it will follow when it decides to make such rules. Click here for an earlier update on the content of the draft statement of policy. The FSA is therefore carrying out this exercise on the FCA’s behalf to ensure that the statement of policy is ready for legal cutover in April 2013.

The making of temporary product intervention rules

The draft statement of policy sets out circumstances in which the FCA considers it necessary to make temporary product intervention rules, and the process for doing this. Although the paper states that the ability to make temporary product intervention rules will be an important part of the FCA’s early intervention tool kit, it also confirms that the FCA does not intend to make such rules on a regular basis, and only after careful consideration.

The paper states broadly that the FCA will make temporary product rules to advance its objectives, namely, consumer protection, competition and market integrity.

In respect of the consumer protection objective, situations where the FCA is likely to find it necessary or expedient to make temporary product intervention rules is where “urgent product-related issues arise in the market, which are deemed likely to cause significant consumer detriment if left unaddressed for the time it would take to consult on product intervention rules”. This is obviously intentionally high level to give the FCA sufficient scope to take action entirely within its own discretion. The paper does go on to say, however, that “these are expected to be cases of serious concern where to delay action would jeopardise the FCA’s effectiveness in delivering on its consumer protection objective and/or produce a significant redress bill for the industry”. This suggests that the FCA would only make such rules where there is clearly a wide-spread market issue akin to situations that we have seen arise over the last few years, for example in relation to payment protection insurance.
In advance of its competition objective, the FCA will intervene where it observes "urgent and significant problems which are unlikely to be corrected by the market". Again, this gives the FCA a very wide discretion to take action, and given that competition is a new objective for the FCA, unlike with consumer protection, it is not possible to estimate what their likely future use of this power will be based on comparable past action in this context. The paper gives even less detail as to the temporary product intervention rules that the FCA might make to further its market integrity objective, other than it will make rules when ordered to do so by HM Treasury.

**Practical examples of when temporary product intervention rules may be used**

The FSA does, more helpfully, provide an indicative list of examples of the types of situation that it may use temporary product intervention rules in practice. However, the paper does emphasis that it is not possible to provide complete certainty as to how the FCA may use temporary product intervention rules.

The examples include:

> Products that would be acceptable but for the inclusion of exclusion of particular features;

> Products where there is a significant incentive for inappropriate or indiscriminate targeting of consumers;

> In relation to markets or products where a lack of competition creates the potential for consumer detriment:
  - where a product or feature of a product is so complex that most consumers would not be able to understand the risks or features of the product they are purchasing;
  - where features are designed to exploit consumers’ focus on the headline price as opposed to outcomes in the long term.

Although not listed as an indicative example in the paper as an area where the FCA might use its powers, the paper does state that the FCA will go further than the FSA in challenging firms about value for money offered by their products, and will use temporary product intervention rules where this is felt to be necessary. This reiterates the message given on the FCA’s role in querying value for money in the **FCA’s approach paper**, published in October 2012.

**Transparency of temporary product intervention rules**

As provided for in the FCA’s statement of policy, any temporary product intervention rules that the FCA publishes will be published on its website. The rules will state how long they will remain effective, following which they will lapse automatically. They will also be set out in the FCA handbook for so long as they are effective. If temporary product intervention rules are withdrawn before the end of their effective period, the FCA will publicise this by issuing a statement on its website. Note that before publishing a rule the FCA may not...
have time to contact all affected firms directly, but will use reasonable
efforts to ensure that information about a rule is communicated widely.
Firms should therefore ensure that they check the FCA website on a regular
basis.

Unenforceability provisions
The FCA may decide to incorporate unenforceability provisions in any
temporary product intervention rules it makes, such that any agreements
entered into after the rules are introduced and in contravention of the rules
are unenforceable. The paper clarifies that agreements entered into prior to
the introduction of the rules will not be unenforceable or subject to automatic
compensation – consumers wanting to seek compensation will have to
establish their claim in the usual way under section 150 of FSMA.

What is not clear from the consultation is the effect that a product intervention
rule will have on the analysis of whether agreements entered into prior its
introduction were in breach. It is certainly arguable that the subsequent
removal of a product from the market, for example, is cogent evidence that
sales prior to that date should not have been made. The FSA clearly does not
intend product intervention rules to have retrospective impact, but the reality
may be that it will be difficult for firms to resist a finding that sales prior to their
introduction should not have been made.

Extra-territorial application of temporary product rules
Where potentially harmful products are developed overseas and sold by
intermediaries based in the UK, they may become subject to action from the
FCA, including the application of temporary product intervention rules. The
FCA will ensure that it co-ordinates with the European Commission and the
European Supervisory Authorities and overseas regulators, as relevant, in
this respect.

The MiFID review is incorporating product intervention rules, and so it looks
likely that at a European level, the power to impose such rules will be
conferred on EU regulators. The FCA will ensure that it’s rule making is
consistent with any European rules in this area.

What next
The FSA is giving the market 2 months to respond to the consultation. The
text will be published on the FCA website following legal cutover.
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