

08/19**

Financial Services Authority

Regulating retail
banking conduct of
business

November 2008



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The Financial Services Authority invites comments on this Consultation Paper. Please send your comments to reach us by 16 February 2009.

Comments may be sent by electronic submission using the form on the FSA's website at www.fsa.gov.uk/pubs/cp/cp08_19_response.html.

Alternatively, you can send comments in writing to:

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It is the FSA's policy to make all responses to formal consultation available for public inspection unless the respondent requests otherwise. A standard confidentiality statement in an e-mail message will not be regarded as a request for non-disclosure.

A confidential response may be requested from us under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Tribunal.

Copies of this Consultation Paper are available to download from our website – www.fsa.gov.uk. Alternatively, paper copies can be obtained by calling the FSA order line: 0845 608 2372.

1 Overview

Purpose

- 1.1 In this Consultation Paper (CP) we are seeking views on a proposed new framework for regulating retail banking conduct of business.
- 1.2 We are grateful to the Banking Code Sponsors (the British Bankers' Association, Building Societies Association and APACS, the UK Payments Association), the Banking Code Standards Board (BCSB), consumer groups, small business representatives and several FSA-licensed firms for the help they have given us in undertaking this review. Our analysis has also benefited from the research undertaken for the Office of Fair Trading's (OFT) recent market study on personal current accounts.¹

Background

- 1.3 Retail banking involves the sale of current and savings accounts and credit products. Responsibility for its regulation is split mainly between the Financial Services Authority (FSA), covering deposit taking under the Financial Services and Markets Act 2000 (FSMA), and the OFT, covering credit products under the Consumer Credit Act 1974 (CCA).
- 1.4 Since we assumed our powers under FSMA in 2001, we have not made comprehensive rules governing the conduct of retail deposit-taking business, only doing so where this is required under European law or necessary to deliver specific consumer outcomes. We have also indicated that we would not take enforcement action against banks and building societies for conduct of business (COB) breaches of our Principles for Businesses (the Principles) unless these have prudential implications.
- 1.5 Self-regulation of banking COB has continued, with the BCSB monitoring and enforcing compliance with the voluntary Banking Codes for dealing with personal and business customers, to which virtually all retail banks and building societies subscribe. We have made arrangements for the BCSB to monitor compliance with

1 *Personal current accounts in the UK; an OFT market study* (July 2008). Available at www.offt.gov.uk/shared_offt/reports/financial_products/OFT1005.pdf

most of the applicable FSA COB rules on our behalf for firms that subscribe to the Codes, and have signed a Memorandum of Understanding (MOU) with it.

- 1.6 Although these arrangements have generally worked well for deposit taking, we consider it appropriate to review whether they remain the right model for the future, particularly in the light of our desire to address more comprehensively and effectively prudential and conduct risks affecting the whole of firms' retail market activities. In addition, regulation of payments services is about to be introduced. In November 2009 we will become the main competent authority for the Payment Services Directive (PSD), which introduces conduct of business standards affecting most retail bank accounts².
- 1.7 Our review has shown that there are two types of potential failure in this market³: market failure arising from asymmetric information held by providers and consumers; and regulatory failure (including failure arising from deficiencies in the current arrangements). We discuss these issues further in Annex 2's market and regulatory failure analysis. We also note the increased volume of complaints arising in relation to current and savings accounts. While these involve only a small percentage of total users, minor regulatory and market failures can add up to significant cumulative numbers.

Summary of our proposals

- 1.8 We have decided to propose changes to the current arrangements, mainly because:
- it is increasingly anomalous that the FSA does not regulate retail consumers' core financial services relationship especially now that we are to regulate payments services;
 - this anomaly potentially restricts our regulatory effectiveness because we are unable to look comprehensively across all risks affecting firms' retail market activities within our scope;
 - there may be scope for consumer detriment because in this key sector we are not enforcing Principle 6 (*a firm must pay due regard to the interests of its customers and treat them fairly*), the cornerstone of our regulatory approach; and
 - our risk-based approach has affected the cost benefit case for voluntary self-regulation of retail banking services.
- 1.9 Although our review has confirmed that the Codes' scope is broadly correct and the BCSB monitors and enforces them quite effectively, its regulatory approach is less principles-based and transparent than ours. Deterrence may also be limited by the fact that the BCSB does not have the power to fine. There are some gaps in the Codes' content, including no overarching fairness objective equal to our Principle 6.

2 See also Chapter 3. Fuller information on the PSD is available at: www.fsa.gov.uk/pages/about/what/international/psd

3 i.e. relevant to conduct of business rather than prudential/capital issues.

4 CP08/19: Regulating retail banking COB (November 2008)

- 1.10 We are therefore proposing the following new framework for COB regulation of business within the FSA's remit:
- full application of the Principles to the regulated activities of accepting deposits and issuing e-money (to the extent compatible with European law);⁴
 - some new high-level rules applying to retail banking services outside PSD scope for consumers and small businesses in a short Banking Conduct of Business sourcebook (BCOBS);
 - transfer of our existing COB rules and guidance applying to deposit taking to BCOBS; and
 - monitoring and enforcement by the FSA, integrated into our wider risk-based approach to the supervision of the relevant firms and groups.
- 1.11 We recognise that our proposed new framework has implications for the consumer protection currently provided by the Banking Code. We understand the industry may wish to develop voluntary industry guidance, suggesting ways to comply with these requirements, which would preserve valuable elements of the current Codes and other relevant material⁵.
- 1.12 For credit cards and other consumer credit, we will work with the OFT, the Code Sponsors and other relevant industry and consumer bodies to ensure the protections given by the current arrangements are preserved. We would expect to agree a concordat with the OFT to set out our respective responsibilities for the regulation of retail banking and how we would co-operate when addressing issues which cross the boundary between our respective remits.
- 1.13 We have considered several timing options for making these changes, not least because of the wider challenges currently faced by the banking system, but have decided to propose implementation at the same time as the PSD comes into effect (1 November 2009), with appropriate transitional provisions where possible. Amendments in terms and conditions and systems will be required of many firms by the PSD and responses to our cost benefit analysis survey have indicated one-off costs may be lower for many of those firms if both sets of changes are made at the same time.

Structure of this paper

- 1.14 The rest of this paper is structured as follows:
- Chapter 2 summarises the current self-regulatory arrangements (with more detail in Annex 1);
 - Chapter 3 sets out the results of our review of these arrangements and discusses the factors which we consider relevant to determining the right regime for the future;

4 References to e-money issuers in this CP do not include the 50 small e-money issuers who are exempt from authorisation and supervision by the FSA.

5 We recognise, however, that the Code Sponsors have not yet had the opportunity to fully consider our proposals (including the draft rules) with their members.

- Chapter 4 describes the new framework we are proposing and the high-level rules for retail banking services that would be part of this;
- Chapter 5 includes our recommendations;
- Annexes 2 and 3 contain a cost benefit analysis of our proposals and an analysis of their compatibility with our statutory objectives and the principles of good regulation;
- Annex 4 lists the consultation questions; and
- Appendix 1 includes a draft Banking Conduct of Business sourcebook.

Next steps

- 1.15 We invite views on the questions set out in this CP by 16 February 2009. We will publish feedback on responses in a Policy Statement, together with final Handbook text if we decide to make or amend any rules or guidance.

Who should read this paper?

- 1.16 This CP will be of interest to firms which carry on the regulated activities of accepting deposits and issuing e-money. These include:
- UK authorised banks and building societies;
 - UK authorised e-money issuers;
 - credit unions; and
 - incoming EEA branches of credit institutions and e-money issuers.
- 1.17 It may also be of interest to subscribers to the Codes which we do not regulate.

Consumers

These proposals will be of interest to consumer groups and personal and small business consumers of banking services because of the implications for how they are treated in their core relationship with the financial services industry.

2 Current self-regulatory arrangements

- 2.1 This chapter provides a high-level summary of the current arrangements for the regulation of the conduct of deposit-taking activities, within the self-regulatory framework of the Banking Codes. It also summarises the approach and supervisory tools of the Banking Code Standards Board (BCSB). Further detail on the current arrangements (including the content of the Codes and the process to review them, the BCSB's activities, and its relationships with other relevant bodies) is set out in Annex 1.⁶

Background

- 2.2 Since 1992 the industry has voluntarily set out agreed standards for the conduct of retail banking business and the standards of behaviour that customers may expect of their providers of banking services. These standards have developed into two Banking Codes (the first Banking Code took effect from March 1992; the first Business Banking Code from March 2002) and are intended to supplement or complement statutory regulatory standards.
- 2.3 The Codes are drawn up, and their content maintained, by three industry 'sponsor' organisations: the British Bankers' Association (BBA), the Building Societies Association (BSA) and APACS, the UK Payments Association⁷. Subscription to the Codes is voluntary (and subscription is not a condition of membership of any of the sponsor organisations). All banks, building societies and other financial services providers offering deposit taking and/or non-mortgage lending may apply to become subscribers. As at 30 September 2008, there were 119 subscribers to one or both of the Codes⁸, comprising banks, building societies, one credit union, and other financial service providers (including National Savings & Investments). Virtually all providers of retail deposit products (aside from credit unions) subscribe to the Banking Code. The BCSB undertakes day-to-day monitoring of adherence by subscribers, and enforcement of the Codes under a contractual relationship with each subscriber.

6 Further information can also be found through the website of the BCSB and the organisations that sponsor the Banking Codes. The BCSB's website address is: www.bankingcode.org.uk

7 The Business Banking Code is sponsored only by the BBA and APACS, though other institutions such as building societies may also choose to follow this Code.

8 Not counting individual firms (or trading names) within a subscriber group separately.

- 2.4 Work in the late 1990s leading up to the establishment of the FSA, and consideration of what our scope should be at the outset, took account of these arrangements. The decision was taken not to extend all of the FSA's Principles and conduct of business (COB) regulation into this area. Where FSA COB requirements do apply to deposit-taking activity⁹, most are monitored on our behalf by the BCSB where the firm subscribes to the Banking Code¹⁰. These include requirements to implement the European Distance Marketing Directive.

The Codes

- 2.5 As indicated above, there are now two Banking Codes. The Banking Code covers dealings with personal customers, and is now in its 8th edition (the latest edition introduced in March 2008). The Business Banking Code covers business customers and is now in its 4th edition (the latest also in March 2008).
- 2.6 The two Codes, together with associated Guidance produced for subscribers (see Annex 1), contain Key Commitments to customers and detailed information on how customers will be dealt with throughout the whole product life cycle, from marketing, account opening and maintenance, and the provision of information on changes to terms, conditions and interest rates, moving a retail banking service and account closure. They also cover standards in relation to help for customers when something goes wrong, including when someone is experiencing financial difficulties. There is also material to remind customers of their responsibilities in using banking services; for example, in relation to PIN numbers and online security.
- 2.7 The Codes have deliberately been developed with a view not to constrain subscribers' ability to set their own prices or otherwise restrict competition in the banking industry. Since their inception, both Codes have been reviewed periodically. The primary intention of such reviews is to consider whether the Codes (and the associated Guidance) continue to reflect market developments and innovations, relevant changes in the wider regulatory environment, and any new customer issues that have arisen and are not adequately addressed by the Codes as they stand. The Codes are currently reviewed every three years, and the last three reviews have been led by an external independent reviewer appointed by the Sponsors.

The BCSB

- 2.8 The BCSB was formed in 1999. It is funded by fees paid by subscribers, and reviews its budget annually. As stated in its Annual Reports and other public material, its key objectives are:

⁹ For example, in our Conduct of Business sourcebook for investment business (COBS), the relevant parts of COBS 4 (financial promotions), COBS 5 (distance communications), COBS 13 (key features disclosure with respect to cash deposit ISAs and Child Trust Funds) and COBS 15 (cancellation).

¹⁰ For example, in respect of the monitoring and supervision of certain financial promotions, under a Memorandum of Understanding between the FSA and BCSB (see: www.fsa.gov.uk/pubs/mou/fsa_bcsb.pdf). In addition, in October 2008 the FSA and BCSB issued a joint communication on the advertising of savings accounts (see: www.fsa.gov.uk/pages/Doing/Regulated/Promo/thematic/savings_advertising.shtml).

- to assist financial service firms to interpret and meet the requirements of the Banking and Business Banking Codes;
- to monitor and enforce compliance with the Codes and take disciplinary action for material breaches;
- to identify any gaps and deficiencies in the Codes that could lead to consumer detriment and to advocate change; and
- to ensure all significant providers of retail banking services subscribe to the Codes.

2.9 The BCSB seeks to take a risk-based and proportionate approach to monitoring, concentrating on, and allocating its resources to, those areas which its analysis suggests have the greatest potential for consumer detriment¹¹. Its monitoring activity employs a range of tools, including:

- pre- and post-application reviews;
- review visits to subscribers;
- themed reviews;
- Annual Statements of Compliance from subscribers;
- specific investigations;
- ongoing relationship management contact; and
- information received via the BCSB Helpdesk and from a range of other external sources including consumer bodies, the media and other regulators.

2.10 Decisions concerning disciplinary or enforcement action are taken within the BCSB's overall risk-based framework and in accordance with an internal disciplinary process that is set out in its rules. Material breaches of the Codes (and/or Guidance to the Codes) are reported to the BCSB Board for enforcement action. Sanctions available to the BCSB for material breaches include: publication in the BCSB Annual Report; a direction on future conduct; a recommendation on remedy of past conduct; a Board warning or reprimand; public censure; or cancellation or suspension of registration. Action can involve a recommendation for customer redress and compensation where appropriate. The BCSB does not have the power to levy fines.

Other bodies

2.11 The BCSB maintains close contacts with other relevant bodies with a view to avoiding either gaps in regulatory coverage or unnecessary duplication. These bodies include the FSA (with whom the BCSB has signed an MOU), the OFT, the Financial Ombudsman Service (FOS) and the Advertising Standards Authority.

2.12 The FOS can consider complaints from eligible complainants relating to banking business – including in respect of deposit-taking activities, loans and credit, and credit cards.

11 BCSB September 2007 publication on its monitoring and enforcement activity: *Ensuring a fair deal for customers*

3 Developing the right regime for the future

- 3.1 This chapter reports the findings of our review of the effectiveness of the self-regulatory arrangements described in the previous chapter (and in Annex 1). It also discusses the factors which we consider should inform consideration of the appropriate regulatory framework for deposit-taking activities in the future, taking account of the new conduct of business requirements which will come into effect as a result of the implementation of the PSD. In the light of this, the chapter explains our reasons for proposing a new framework to replace self-regulation in respect of deposit-taking activities.

Findings of our review of the effectiveness of the current arrangements

- 3.2 Between March and July 2008, as part of the overall review described in this CP, we reviewed the effectiveness of the current self-regulatory arrangements, including the BCSB's monitoring and enforcement of the Banking Codes regime in respect of activities within our (deposit taking) remit¹². In the course of this, we conducted interviews with several Code subscribers and other stakeholders, and considered the BCSB's approach to its activities in practice. The BCSB itself participated fully and openly in this review, and the conclusions we reached are broadly consistent with the findings of an external review the BCSB recently commissioned¹³.

The Codes

- 3.3 A majority of subscribers we spoke to, and several consumer bodies, see the Codes as generally clear, user-friendly statements of good business practice, of value to both consumers and firms. Though some see specific areas of excessive detail, most see a reasonable balance in the Codes between detail and higher-level standards.

12 We estimate that BCSB relationship managers spend approximately 40% of their time monitoring activities that fall within the FSA's remit.

13 As reported in the BCSB's Annual Report for 2007/08, its monitoring strategy and processes were reviewed in the course of the year by independent consultants PKF.

- 3.4 However, there are concerns about aspects of the Codes' content and the triennial review process. There is still not a sufficiently strong overarching fairness objective in the Codes analogous to FSA Principle 6 on treating customers fairly (even though banks are now subject to the Unfair Commercial Practices Directive's prohibition on treating consumers unfairly¹⁴). There are also some other concerns; for example, with respect to when information should be provided to customers. In relation to the Code review process, there is no public consultation on the text of the revised Codes or associated Guidance (hence minimal scope for consumer comment on the wording), nor a systematic cost benefit analysis or impact assessment of changes made or recommendations rejected.

The BCSB

- 3.5 In respect of the BCSB, our general conclusion is that its supervisory tools and processes seem appropriate to meet its supervisory objectives and its Board and Executive of good quality and focused expertise; and that the BCSB can be successful in influencing firm behaviour in respect of Code compliance. Our interviews with subscribers indicate that the BCSB is effective in helping firms interpret and understand the requirements of the Codes. The BCSB is seen as open and helpful within a constructive ongoing relationship with subscribers. We were also given examples of where the BCSB seeks, in both its bilateral and general communications with subscribers, to share and promote good practices it identified. We were told that, where issues or non-material breaches arise, the BCSB will provide feedback to firms and, where appropriate, work with them on remedial plans.
- 3.6 The BCSB appears to employ the full range of the monitoring tools at its disposal in its work. Its relationship manager model seems appropriate in principle and its risk-rating of firms involves similar factors to those we use.
- 3.7 The BCSB's process for thematic work incorporates elements that we would expect to see in an effective approach to thematic supervision. The use of mystery shopping is seen as of particular value. However, our review of its thematic work on basic bank accounts (spanning 2002-08) suggests that changes to subscriber behaviour as a result of thematic work do not always come quickly, particularly where changes to the Codes and/or Guidance are involved. The issues identified by the BCSB for thematic work, in the past and currently, seem appropriate. However, the thematic agenda and robustness of decision-taking does appear dependent to an extent on the judgement and experience of two key senior individuals rather than through the 'operationalised' processes that would apply in a larger organisation (although the monitoring agenda is approved by the Board, which receives updates at each Board meeting).
- 3.8 The BCSB's regulatory approach inevitably reflects the content of the Banking Codes and in our view can tend to focus on detailed rules rather than desirable consumer outcomes or an overarching principle that subscribers must treat customers fairly. We identified this issue in relation to financial promotions, for example, where we think a more principles-based approach would raise standards and accordingly deliver

14 As implemented in the Consumer Protection from Unfair Trading Regulations 2008.

consumer benefits.¹⁵ In addition, although the BCSB's enforcement powers can deliver change and some redress for consumers, its approach is less transparent than the FSA's, both in terms of process and the publication of individual action taken.

- 3.9 Furthermore, though the threat of publicity and resulting reputational damage is seen by firms as a significant disciplinary tool, we believe that the BCSB's deterrence is limited by the absence of a fining power and the Board's relatively low media profile. Information gateways to the FSA and other regulators are narrow, though this has not to date inhibited essential communication when important issues have arisen¹⁶. The BCSB's small size can allow it to act quickly and efficiently, but this also presents 'key person' risks as indicated above (though there is no evidence that this risk has ever materialised). It is not clear to us that it necessarily has sufficient resources readily available if a major problem emerged, though we recognise that it could recruit extra compliance staff or engage external experts if needed.
- 3.10 If current arrangements were to continue, we have heard from the industry that it would welcome greater clarity on the respective responsibilities of the BCSB, FSA, OFT and FOS, and the degree of 'double jeopardy' firms feel they face in respect of conduct of business in the retail banking sector. The issue of clarity is equally important for the regulators themselves and for depositors, and is a factor given additional significance by the implementation of the PSD (see below).

The right regime for the future

- 3.11 Some of the points that have emerged from our review could be addressed through work with stakeholders, including the Code Sponsors and the BCSB, building on the relationship reflected in our Memorandum of Understanding (MOU) with the BCSB. This work could involve, for example:
- re-casting the formal objectives of the current arrangements to be more consumer-centric and outcome-focused for deposit-taking activities;
 - improving the process for Code revision while preserving the independent triennial review;
 - the BCSB taking a power to levy fines for relevant Code infractions; and
 - enhancing the BCSB's capabilities and governance in certain areas, including support to its Board and wider consultation on its own affairs.
- 3.12 However, despite the potential for improving such aspects of the current arrangements, there are a number of reasons why we (and many of the stakeholders we have talked to) do not think self-regulation is the most appropriate model for the future regulation of deposit-taking activities, especially when we become the competent authority for the PSD's COB and other requirements next November.

15 As noted in Chapter 2, in October 2008 the FSA and BCSB issued a joint communication on the advertising of savings accounts.

16 This is a 'two-way' issue, since for example both the BCSB's rules and the FSA's legal framework create impediments to the exchange of information between the two organisations.

- 3.13 The wide scope of the PSD, which will apply to most retail bank accounts¹⁷ and supersede about 40% of the provisions in the current Banking Code, and our proposed supervisory approach are described in the Information Box at the end of this chapter. This shift of responsibility away from the BSCB would increase the complexity, and lack of clarity, of the current arrangements for firms, consumers and the regulatory bodies.
- 3.14 More significantly:
- it is increasingly anomalous that the FSA does not regulate retail consumers' core financial services relationship especially now that we are to regulate payments services;
 - this anomaly (and the narrow information gateways) potentially restricts our regulatory effectiveness because we are unable to look comprehensively across all risks affecting firms' retail market activities within the scope of FSMA; issues with respect to the fair treatment of customers may, for example, not be confined to one category of business;
 - there may be scope for consumer detriment because in this key sector we are not enforcing the overarching Principle 6 (*a firm must pay due regard to the interests of its customers and treat them fairly*), the cornerstone of our regulatory approach; and
 - our risk-based approach has affected the cost benefit case for voluntary self-regulation of retail banking services since 2001.
- 3.15 When the FSA was being established, the CBA case for not extending full enforcement of the Principles (or COB rules) into the area of deposit-taking activities reflected an assessment that the market failure was small. At the time, the BCSB had only just been set up and the prevailing view was that self-regulation was likely to be more cost effective for firms than a detailed rules approach under FSMA. Since then, some more evidence has emerged of consumer detriment, which is discussed in the market failure section of Annex 2 to this paper.
- 3.16 In addition, we have developed and refined our risk-based regulatory approach. Our intention is that firms should be given increased flexibility in how they deliver the outcomes we require. They should be able better to align meeting their business objectives and meeting regulatory requirements. This regulatory approach should also achieve benefits for consumers by fostering (within appropriate parameters and controls) a more innovative and competitive sector.
- 3.17 In seeking to address all these issues, by developing the new framework proposed in the following chapter, we have tried to preserve, as far as practicable, valuable elements of the current arrangements.

Q1: Do you have any comments on our analysis in Chapter 3 and our reasons for proposing a new framework?

17 We are currently consulting on adding perimeter guidance to our Handbook in relation to the PSD, including the definition of those accounts which will be 'payment accounts' and therefore in the scope of the PSD (see Q14 in Appendix 8 of CP08/16 at www.fsa.gov.uk/pubs/cp/cp08_16.pdf).

Information Box: Implications of the Payment Services Directive

The Payment Services Directive (PSD) is a new European Union directive, being implemented in the UK from 1 November 2009, which requires member states to regulate the provision of payment services. The Treasury will make most of the necessary legislation to bring the directive into force in the UK in the form of the 'Payment Services Regulations 2008' (the Regulations).

The Directive covers most payment services, including the provision and operation of 'payment accounts'. Payment accounts cover accounts on which payment transactions may be made and where access to funds is not restricted (as, for example, in fixed-term deposits). The final definition of what is to be covered is subject to the outcome of consultation (see Chapter 8 and Appendix 8 of FSA Consultation Paper 08/16: 'Quarterly Consultation Paper (No.18)' at www.fsa.gov.uk/pubs/cp/cp08_16.pdf). The PSD conduct of business provisions only apply to payment services made in euro or sterling, so primarily to sterling and euro denominated accounts.

The FSA will be the competent authority for most aspects of the new regulatory regime, responsible for the authorisation and registration requirements under the Regulations, as well as overseeing the conduct of business regime. The FSA is currently consulting on specific changes that will be required to its Handbook to carry out its obligations under the Regulations (see FSA Consultation Paper 08/14: 'Implementation of the Payment Services Directive – changes to the FSA Handbook' at: www.fsa.gov.uk/pubs/cp/cp08_14.pdf).

As an indication, relevant conduct of business changes arising from PSD implementation will include:

- a shift to statutory obligations for 'payment services business';
- some detailed changes on information provision before the opening of a 'payment account', and subsequently amending its terms, and in respect of individual transactions;
- specific requirements on the 'value dating' and availability of funds to customers (for example, funds to be available to the payee immediately after funds have been credited to a payment account);
- the content of the terms and conditions of the account (a 'framework contract');
- provisions on post-sale information;
- requirements on the operation of accounts (including interest rate changes) and termination; and
- requirements on changes to information already provided, for example, 2 months notice of changes to framework contracts.

The conduct of business requirements of the Regulations will be supervised by the FSA under a complaints-led approach as required by the PSD; this means that oversight of the conduct of business regime will be driven by complaints made to the FSA about breaches of the Regulations.

4 Proposed new framework

- 4.1 This chapter explains our proposed new framework for the COB regulation of retail banking business within our remit (i.e. deposit-taking activities but not consumer credit). This framework would involve fully applying all the Principles to the conduct of this business, supported by some high-level rules. The chapter also indicates how we would expect to operationalise this framework. It also considers the particular position of e-money issuers and credit unions.
- 4.2 The proposed new framework is set out diagrammatically at the end of the chapter.

Overview

- 4.3 The proposed new framework would be based on the Principles (fully applied to all deposit takers¹⁸ and other regulated e-money issuers to the extent compatible with European law), the Unfair Terms in Consumer Contracts Regulations (UTCCR), the proposed PSD Regulations and some high-level, outcomes-focused rules in a short Banking Conduct of Business sourcebook (BCOBS).
- 4.4 The high-level BCOBS rules to support the Principles would focus on areas outside the scope of the PSD where greater transparency and clarity are needed, and on issues of general fairness. Alongside new high-level rules, BCOBS would also subsume those existing COBS requirements that already apply to deposit taking (and are currently largely monitored by the BCSB where firms subscribe to the Banking Codes). As explained later, there would be some differences in the scope of application of BCOBS compared with the Banking Codes; for example, in that it would apply (subject to PSD requirements) to accounts in all currencies, not just to accounts in sterling.
- 4.5 The OFT has recently completed a consultation on its market study on personal current accounts. We are liaising closely on the interaction between its potential remedies for the weaknesses identified and our proposals. We believe that the high-level rules we are suggesting, together with the PSD requirements, should help to address a number of issues identified in the market study, for example, lack of transparency on pricing of relevant products and services.

18 All references to deposit takers and credit unions exclude credit unions in Northern Ireland, which are not regulated by the FSA.

- 4.6 We would monitor and enforce compliance with the Principles and BCOBS. This would principally involve extending our TCF approach and conduct risk supervision to deposit taking, and undertaking thematic work on any areas of consumer detriment (or potential detriment) we identify. There would be no changes to current complaints-handling procedures – including to the role of the Financial Ombudsman Service.

Applying the Principles

- 4.7 Currently, our guidance on the application of the Principles¹⁹ says that in applying them with respect to accepting deposits and issuing electronic money we will proceed only in a prudential context. That is to say, we would not expect to exercise the powers brought into play by a contravention of a Principle unless the contravention amounted to a serious or persistent violation which had implications for confidence in the financial system, or for the fitness and propriety of the firm or for the adequacy of the firm's financial resources.
- 4.8 Under the proposed new framework, we would remove this guidance and monitor and enforce compliance with relevant Principles in a conduct of business context as well as a prudential context, much as we currently do with respect to the conduct of investment, general insurance and mortgage business. The most relevant Principles being applied would be:
- *Principle 6* – A firm must pay due regard to the interests of its customers and treat them fairly; and
 - *Principle 7* – A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.
- 4.9 Principles 1 (A firm must conduct its business with integrity), 2 (A firm must conduct its business with due skill, care and diligence) and 11 (A firm must deal with its regulators in an open and cooperative way, and must disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect notice) would in future also apply in a conduct of business context. We would expect Principle 9 to remain of less relevance to the conduct of deposit-taking activities, given that its concepts of suitable advice and discretionary decisions for customers do not apply in the same way as for other FSA-regulated activities.
- 4.10 Full application of all the Principles should not in practice require significant changes in behaviour for most deposit takers. All firms (including e-money issuers) are now subject to the Unfair Commercial Practices Directive's prohibition on treating consumers unfairly²⁰. For Banking Code subscribers, the Code's fairness commitment covers some of the same ground, but many firms we have spoken to during the pre-consultation stage have told us that they seek to apply the Treating Customers Fairly principle across their retail banking business anyway.

19 See the Principles for Businesses (PRIN) 1.1.3G.

20 Under the Consumer Protection from Unfair Trading Regulations 2008.

Q2: Do you agree with our proposal to apply all the Principles fully for all firms that accept deposits or issue e-money?

Banking COB sourcebook

- 4.11 To underpin a more principles-based approach, the new framework would introduce FSA conduct of business rules in BCOBS (see draft in Appendix 1). As already indicated, our scope to make rules in this area is constrained by the broadly ‘maximum harmonising’ nature of the PSD, whose COB requirements for payment accounts will be set out in the Payments Services Regulations, not the FSA Handbook.
- 4.12 BCOBS would apply to ‘retail banking services’, a proposed new defined term covering both accepting deposits and providing services in relation to deposits (for example, cheques and foreign exchange services). However, it would not apply when the service is within the scope of the PSD and subject to harmonised requirements.
- 4.13 So, the rules in BCOBS would apply fully to all accounts that are not payment accounts (including cash deposit Child Trust Funds and all accounts denominated in currencies other than sterling or euro). For payment accounts, BCOBS rules would apply, subject to European law, including the rules relating to areas not covered by the PSD (for example, financial promotion and moving a retail banking service)²¹. BCOBS would also apply to structured deposits²².
- 4.14 As regards the consumers to be protected by BCOBS, our policy intention is broadly to replicate the coverage of the Banking Codes and the PSD but, to minimise the number of definitions firms have to apply, using definitions that are already used in our Handbook or definitions we are consulting on elsewhere. We are therefore proposing that a ‘banking customer’ for the purposes of BCOBS is defined as:
- a consumer (currently defined in our Handbook as any natural person acting for purposes outside his trade, business or profession);
 - a micro enterprise (we are currently consulting in CP08/14 on a definition for micro-enterprise for inclusion in our Handbook Glossary; this would cover an enterprise which employs fewer than 10 persons and has a turnover or annual balance sheet that does not exceed €2 million including self-employed persons, family businesses and partnerships and associations regularly engaged in an economic activity);
 - a charity with an annual income of less than £1 million; and
 - a trustee of a trust which has a net asset value of less than £1 million.

The definition of micro-enterprise (not being restricted to overall group turnover) is thus wider in scope than the range of business customers covered by the Business Banking Code, and we would welcome comments on the implications of this proposed change.

21 Once our proposed PSD perimeter guidance has been finalised, we intend to consider whether any other account types which are not classified as ‘payment accounts’ require specific BCOBS rules in the interests of consumer protection.

22 Structured deposits are technically covered by the Banking Codes at present; however it is not evident that this is always recognised on a day-to-day practical basis. The proposed new framework would unambiguously cover these as deposit products (as is the case already under the FSA’s Financial Promotions rules).

4.15 In line with our approach to conduct of business requirements for investment business and general insurance, we propose that BCOBS should be structured to reflect the way most firms organise their business, moving from financial promotion and information disclosure to post-sale services. The draft on which we are consulting in Appendix 1 has the following structure:

- application;
- communications with banking customers and financial promotions;
- distance communications;
- information to be provided to banking customers;
- post-sale requirements;
- cancellation; and
- annexes (with further detail on distance marketing requirements).

4.16 As indicated above, BCOBS would comprise a mixture of existing and new requirements.

Carrying forward COBS rules already applying to deposit taking

4.17 Currently several requirements relate to the conduct of deposit taking in COBS, which came into effect in November 2007 after a fundamental review. These include the relevant parts of:

- COBS 4 (communicating with clients, including financial promotions);
- COBS 5 (distance communications; including the requirements of the Distance Marketing Directive and the E-Commerce Directive);
- COBS 13 and 14 (which contain, amongst other things, the key features disclosure requirements for cash deposit ISAs and CTFs); and
- COBS 15 (cancellation).

4.18 Other than extending cancellation rights to mirror those currently given in the Code, these COBS requirements would be reflected in BCOBS and so, essentially, would have the same effect. The change (for Code subscribers) would be that, in future, we would monitor compliance with all these requirements²³.

Some new high-level conduct of business rules for retail banking services

4.19 The areas that would be covered by new high-level rules in BCOBS would primarily relate to information to be provided to banking customers and post-sale requirements. Compared to the Banking Codes, these new requirements could result in some key information in future having to be disclosed before rather than after an account is opened or a service provided (for aspects of account operation not covered

²³ If we decide to introduce a BCOBS as a result of this consultation, there would be consequential changes to COBS and some other Handbook modules (e.g. CRED and ELM). We would consult on these and any proposed transitional provisions later.

by the PSD e.g. cheques and non-payment accounts). The proposed new information disclosure requirements may be more extensive for some accounts than at present.

- 4.20 In respect of information to be provided to banking customers, there would be high-level rules and guidance on the provision of:
- appropriate information, pre- and post-sale, in good time and in a comprehensible form, so that a customer can take decisions on an informed basis about any arrangement proposed for a banking product or service;
 - information on matters such as the firm, the different types of service provided by the firm which may be of interest to the customer (if this is considered to be ‘appropriate information’), the terms and conditions of the product or service, interest rates, costs and charges, complaints, compensation²⁴ and cancellation; and
 - regular statements to be made available for non-payment accounts where appropriate.
- 4.21 BCOBS would also include guidance on some of the matters firms should consider in determining when to provide appropriate information and the information that should be provided. Guidance also states that customers should be provided with any changes to interest rates and terms and conditions.
- 4.22 For post-sale requirements, there would be high-level rules and guidance on:
- the provision of a prompt, efficient and fair level of service;
 - the fair treatment of customers in financial difficulties (with respect to retail banking services, not activities within the scope of the Consumer Credit Act, outside our remit);
 - a prompt and efficient service to enable a customer to move to a retail banking service provided by another firm (this rule would therefore apply more widely than the Codes as it would apply, for example, to cash deposit ISAs); and
 - appropriate arrangements to enable banking customers to trace and have access to funds in dormant accounts²⁵.
- 4.23 We would welcome views on the detail of these proposals which can be found in Appendix 1.

Section 150 rights

- 4.24 Under Section 150 of FSMA, private persons who have suffered loss as a result of a firm’s contravention of an FSA rule have the right to take action in the courts for damages. These rights do not attach to breaches of the Principles but are available

24 Consultation documents issued by the UK tripartite authorities (the FSA, HM Treasury and the Bank of England) in conjunction with the Financial Services Compensation Scheme (FSCS) in 2008 stated that the FSA would consider how consumer awareness of the FSCS could be improved. How banks should communicate compensation related information to consumers is therefore being considered as part of our work on Banking and Compensation Reform (see www.fsa.gov.uk/Pages/About/Teams/Banking/reform_project/index.shtml). We will include any proposals on these issues in a consultation paper in 2009.

25 HM Treasury is proposing a voluntary scheme (the reclaim fund) that will manage bank/ building society dormant accounts. The Dormant Bank and Building Society Accounts Bill is currently before Parliament. We intend to publish a consultation paper on the implementation of the Bill once it receives Royal Assent.

with respect to breaches of almost all FSA conduct of business rules. So, in line with this approach, we propose that such rights should apply for BCOBS rules.

Proposed application of BCOBS

Incoming EEA branches

- 4.25 We are currently reviewing our passporting regime to ensure it remains proportionate and risk-based in line with market conditions. This review will focus in particular on how the passporting regime meets our consumer protection objective where firms are undertaking retail activities. Our present plans are to consult in Q1 2009 on any proposals to change our rules arising from that review. Subject to the outcome of this work, our current intention would be to protect banking customers by applying BCOBS (consistently with relevant EU law) to UK branches of credit institutions authorised in another EEA state²⁶, several of whom currently subscribe to the Banking Codes.

Credit unions

- 4.26 We already apply the Principles in full to credit unions in Great Britain²⁷ and so the proposed full application for conduct of business would not constitute a change for these organisations. Similarly, we already monitor compliance with existing COBS rules that apply to credit unions. Credit unions will be exempt from the PSD Regulations. As far as the proposed additional high level rules in BCOBS are concerned, we do not believe that they would require credit unions significantly to alter their existing practices to the extent that the rules are relevant to a union's activities (not all will be). For the one credit union that currently subscribes to the Banking Code, the proposals would involve a move to high-level requirements instead of the detail in the Code.
- 4.27 Given the nature of the high-level requirements that would be relevant, we do not envisage that the proposed new framework would significantly alter our approach to supervising and monitoring credit unions. In applying any changes, we would wish to do so within the overall regulatory regime we have developed for credit unions that is practical in focus and takes account of their special characteristics²⁸.
- 4.28 We would welcome any further comments from credit unions and their representatives on the proposals in this CP. We are able to vary the way in which specific requirements apply to credit unions, if there is a case.

26 The EEA comprises Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovak Republic, Republic of Slovenia, Slovenia, Spain, Sweden, the UK, Iceland, Liechtenstein, and Norway.

27 See the Credit Unions sourcebook (CRED) 3.1.3G.

28 However, credit unions are aware that we are also currently reviewing the prudential aspects of our CRED sourcebook, partly driven by HM Treasury's recent consultation on the range of activities that credit unions might offer in future (*Proposals for a legislative reform order for Credit Unions and Industrial & Provident Societies in Great Britain* (July 2008)).

E-money issuers

4.29 Some of the COBS rules that would be transferred to BCOBS already apply to regulated e-money issuers (for example, with respect to cancellation rights) and we are proposing that these should continue to apply. Since the PSD COB requirements will cover all key aspects of these firms' activities (and we are proposing to fully apply the Principles to issuing e-money), we do not propose to apply any other BCOBS rules to them.

Q3: Do you have any comments on our proposals for a Banking Conduct of Business sourcebook and the draft Handbook text in Appendix 1?

Q4: Do you have any comments on our proposed use of the definition of micro-enterprise to cover business banking customers?

Q5: Do you have any comments on the proposed application of BCOBS to incoming EEA branches and e-money issuers?

Q6: Do you have any comments on the proposed application of the requirements in BCOBS to credit unions?

Industry guidance

4.30 Under the new framework, the industry may wish to develop some industry guidance to support the Principles and high-level requirements in BCOBS. In particular, we understand that some stakeholders would not wish to see a complete loss of appropriate detailed material from the Banking Codes (and associated Guidance for subscribers) and some other codes/guidelines that consumers or the industry find particularly helpful. Within our remit, such industry guidance might cover, for example:

- clearing information;
- online banking;
- basic bank accounts;
- the provision of information on interest rate changes, for non-payment accounts;
- moving a retail banking service;
- Personal Identification Numbers;
- cash machines;
- retention of the BBA/BSA Code of Conduct for the Advertising of Interest Bearing Accounts; and
- ISA transfer guidelines.

4.31 If such guidance were developed, it would be open to the industry to ask the FSA to formally confirm it, in the manner described in the FSA's Policy Statement 07/16²⁹ on Confirmation of Industry Guidance (including appropriate consultation with stakeholders, including consumer representatives)³⁰.

Q7: Do you think there are elements of the current Banking Codes and other relevant codes/guidelines that would not appear in the PSD Regulations or BCOBS (as proposed in this CP) but which ought not to be lost?

Operationalising the new framework

Monitoring

4.32 Our approach to supervising and monitoring the conduct of retail deposit-taking activities under the proposed new framework would be carried out within our overall approach to the supervision of regulated firms, including as set out in the relevant parts of our Supervision manual (SUP). The firms that would be covered by the full application of the Principles and/or by BCOBS are already authorised and/or regulated by us (whether banks, building societies, credit unions, e-money issuers or others). So what would be involved would be an extension of our business oversight rather than the creation of a wholly new regulatory regime, as has been necessitated by some previous changes in our scope. Furthermore, as already indicated, some FSA conduct of business rules already apply to deposit taking and in some of these areas we are already monitoring them, or liaising with the BCSB on the BCSB's monitoring of them under the framework of the MOU between us.

4.33 As with other areas of our supervisory activity, we would apply a risk-based approach to the necessary additional supervision and monitoring of deposit-taking activity under the new framework. As set out in SUP, the purpose of taking a risk-based approach is to focus our resources on mitigating risks to our regulatory objectives and to have regard to the need to use our resources in the most efficient and economic way. Our approach to the risk assessment of firms encompasses both the impact of such risks were they to crystallise and the probability of their doing so. New risks arising from the conduct of deposit taking would be factored into this overall approach to risk assessment as appropriate. The way in which we approach banking conduct of business regulation would also need to sit sensibly with our complaints-led approach to the supervision of conduct of business for payment accounts under the PSD Regulations³¹.

29 PS07/16: *FSA confirmation of Industry Guidance – Feedback on DP06/5* (August 2007)

30 We would expect any material relating to customers' responsibilities (e.g. Personal Identification Number security) to take account of our work on consumer responsibilities (Discussion Paper to be published in December 2008).

31 We plan to issue a PSD 'Approach Document' early in 2009 which will include an explanation of how we plan to approach our supervision of payment services.

- 4.34 In line with our move to more principles-based regulation, we would also focus more on the achievement of desirable customer outcomes than on adherence to detailed conduct of business rules prescribing how outcomes must be achieved. This approach is reflected in the proposed size and focus of the draft BCOBS, for example, and our reliance on the Principles. However, as we have stressed, more principles-based regulation does not imply an easing of regulatory standards or of our expectations of firms' behaviour.
- 4.35 We would employ the same range of supervisory tools as we do in other areas³². However, the model would also reflect changes to the structure of our supervision teams as a result of the embedding of our Supervisory Enhancement Programme across the organisation³³, alongside any other relevant developments over coming months. Our monitoring would cover both firm-specific and thematic work. For financial institutions that are already relationship-managed, banking conduct of business would be integrated into our existing risk assessment and supervisory processes, including ongoing contacts with firms, visits, and the ARROW framework³⁴. For smaller institutions that are not supervised on a relationship management basis, BCOBS supervision would be integrated within this existing model. The nature of thematic work is likely (as now) to involve, for example, firm visits, file reviews and/or mystery shopping exercises as well as supporting supervisors through the provision of retail conduct risk specialist support in this area. Decisions on which thematic work warrants attention, and how, would be made within our new conduct risk framework, taking account of the need to focus available resources.
- 4.36 In the area of our monitoring of financial promotions relating to deposit-taking activities, we would undertake all of this work ourselves, rather than referring (lower risk) promotions that raise possible issues to the BCSB as we currently do. In this area too, we would apply a risk-based and principles-based approach; for example, looking at whether a promotion is fair, clear and not misleading and the risk it represents.
- 4.37 We do not currently envisage that additional formal regular reporting would be required of firms – at least initially. Key complaints data, for example, is already reported in respect of deposit taking. We do not believe that additional banking Product Sales Data would be an essential pre-requisite to enable the proposed framework to operate; though changes to these requirements would be considered over the longer term if it became clear that such information was required for effective supervision. Any changes proposed would be co-ordinated with other modifications to Product Sales Data.
- 4.38 However, there would inevitably be some differences in how we would monitor the conduct of deposit-taking activities compared to the current arrangements described in Chapter 2 and Annex 1. These might include, for example:

32 We classify these supervisory tools under four headings: diagnostic, monitoring, preventative and remedial.

33 We announced our Supervisory Enhancement Programme in March 2008 in response to our Internal Audit Report on the supervision of Northern Rock.

34 ARROW stands for the Advanced, Risk-Responsive Operating frameWork; the risk model used in the supervision of firms.

- *A more principles-based focus*, within the framework of the Principles and less detailed requirements in BCOBS compared to the Banking Codes.
- *Treating customers fairly*. Firms would need to be able to demonstrate that they are delivering appropriate TCF consumer outcomes in their deposit-taking activities. (As we have noted in this CP, many firms we have spoken to during the pre-consultation phase of our review have told us that they already seek to apply TCF standards across all their businesses.)
- *Non-subscribers*. FSA-regulated deposit takers that do not currently subscribe to the Banking Codes are likely to be subject to at least some requirements that will be new to them. We would expect the practical implications of this change to vary from firm to firm.
- Some specific features of the current arrangements, including the BCSB's Annual Statement of Compliance, would not be carried forward as a mandatory requirement in respect of deposit-taking activities. However, firms would still of course be expected to maintain adequate and appropriate internal systems, controls and management information.

4.39 In good time before implementation, we would draw up a high-level supervisory strategy, the key points of which we would publish to inform stakeholders affected (as we did with the implementation of the new COBS in November 2007).

Enforcement

4.40 Our approach to enforcing any new rules contained in a BCOBS would follow our general approach to enforcement under FSMA, as set out in Chapter 2 of our Enforcement Guide (EG)³⁵. We would seek to exercise our enforcement powers in a manner that is transparent, proportionate, responsive to the issue, and consistent with our publicly stated policies. We would also seek to ensure fair treatment when exercising our enforcement powers. Finally, we would aim to change the behaviour of the person who is the subject of its action, to deter future non-compliance by others, to eliminate any financial gain or benefit from non-compliance, and where appropriate to remedy the harm caused by the non-compliance.

4.41 There would be differences in the way that we and the BCSB approach enforcement. The main four differences can be summarised as follows:

- *Procedural*: the internal and external procedures for enforcing BCOBS would differ from the BCSB's procedures but would be the same as those for enforcing the rest of our Handbook. Our enforcement procedures are set out in the Enforcement Guide (EG) and in the Decision Procedures and Penalties manual (DEPP)³⁶.
- *Threshold for taking disciplinary action*: as noted in Annex 1, under the BCSB's rules, formal disciplinary action is only taken if there is a material breach. Whilst we take many factors into consideration when deciding whether or not to take enforcement action, we do not have a legal 'material breach' threshold which must be passed first.

35 Available at: <http://fsahandbook.info/FSA/html/handbook/EG.pdf>

36 Available at: <http://fsahandbook.info/FSA/html/handbook/DEPP>

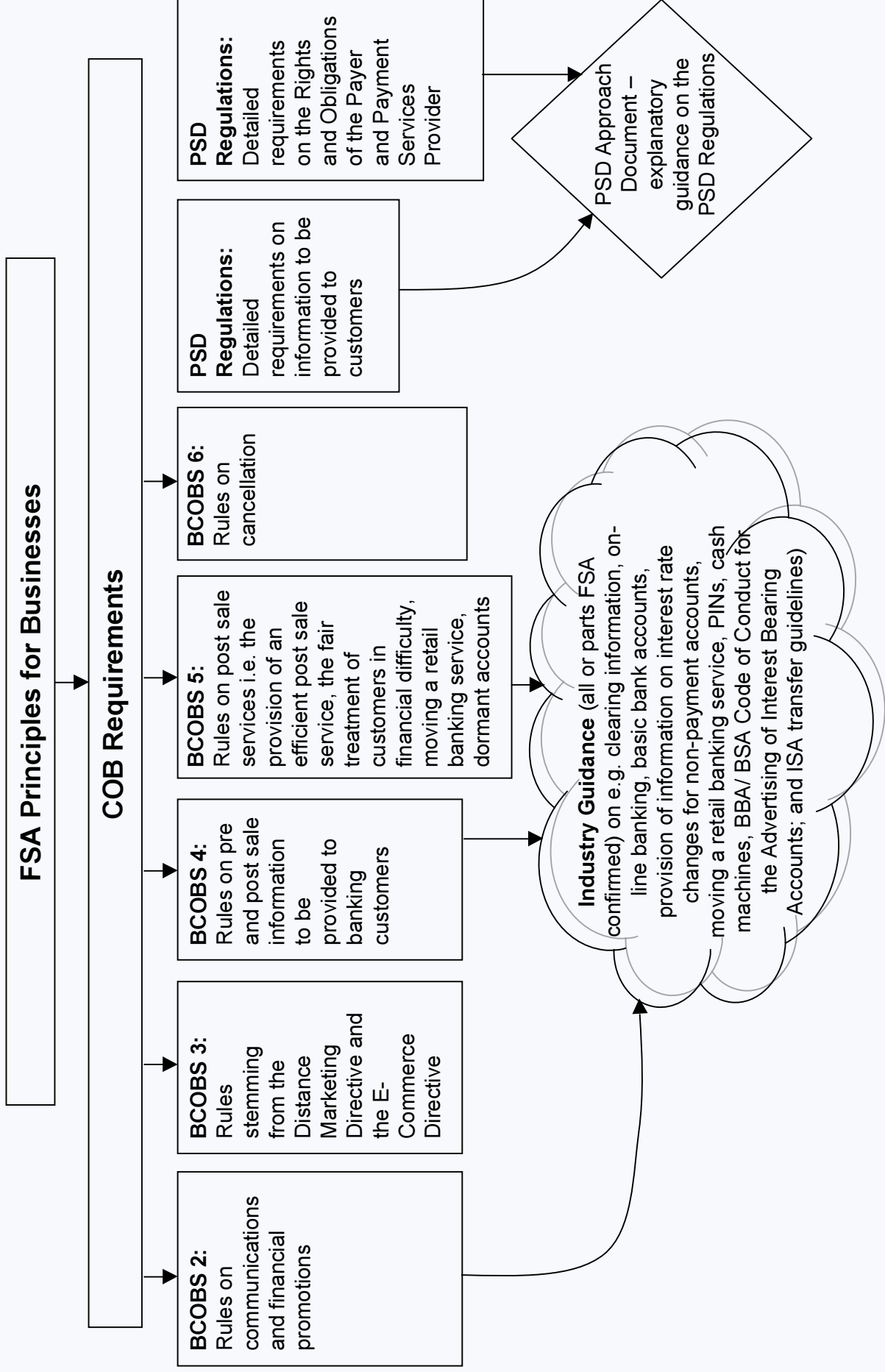
- *Penalties*: the BCSB does not have the power to impose fines for breach of the Banking Codes, whereas we would have the power to do so if the rules contained in BCOBS were breached. Our policy on the imposition and amount of penalties is contained in DEPP 6 and would apply to any BCOBS breaches.
- *Taking cases against individuals*: the BCSB has no power to take a case against an individual; its disciplinary procedures are aimed at firms. We, on the other hand, would be able to take action against individuals who fail to comply with our Statements of Principle and Code of Practice for Approved Persons or have been knowingly concerned in a contravention of BCOBS by an authorised firm.

Interaction with other bodies

- 4.42 If we were to regulate the conduct of deposit-taking activities, we would need to consider how best to strengthen our day to day liaison with those responsible for regulating lending and credit activities (including credit cards). This liaison would continue to include the OFT, with whom we would envisage developing our formal concordats in order to cover our new role and responsibilities. One aspect of this is that we would seek to improve all relevant information sharing gateways in the interests of effective co-operation.
- 4.43 We would also ensure that our continuing contacts with the FOS appropriately covered our responsibilities for deposit-taking activities. The FOS's role would be unchanged. As explained elsewhere, it can consider complaints from eligible complainants relating to banking business, including in respect of deposit-taking activities, loans and credit, and credit cards.

Q8: Do you have any comments on our proposed approach to operationalising the new framework?

RETAIL BANKING CONDUCT OF BUSINESS POSSIBLE INTERACTIONS IN THE PROPOSED NEW FRAMEWORK



Note: This diagram excludes other related HMG Regulations (covering, for example, CTFs, ISAs, information on depositor guarantees, UTCCR and Consumer Protection Regulations).

5 Recommendations and next steps

- 5.1 In the light of the arguments set out in Chapter 3 we have decided to recommend moving away from the voluntary self-regulation of deposit-taking activities, mainly because of the increasingly anomalous nature of the current arrangements now that we are to regulate payment services. We think the proposed new framework described in Chapter 4 would produce a more coherent and integrated regime for retail banking once the PSD comes into effect.
- 5.2 In the CBA analysis in Annex 2, we estimate that the incremental cost to us of operationalising the proposed new framework would be in the region of £2 million per annum, with our costs being recoverable in fees from the A1 (deposit acceptors) activity group. Based on responses to our CBA survey from a representative sample of affected firms, we expect the new framework to generate one-off costs of around £3-10 million, driven largely by training, systems changes and compliance gap analyses. On an ongoing basis (and again based on responses to our survey), we estimate incremental costs to the sector of between £6-9 million (including the direct costs to us mentioned above), generated predominantly by the provisions relating to moving accounts and the enhanced disclosure requirements. These costs will fall proportionately more on the larger firms in the sector. We believe that the changes proposed should benefit consumers and other stakeholders.
- 5.3 We recognise that our proposed new framework for COB regulation within our remit has implications for the consumer protection currently provided by the Banking Code for credit cards and other consumer credit. These are areas regulated by the OFT and the Consumer Credit Act 1974, and we will work with the OFT, the Code Sponsors and other relevant industry and consumer bodies to ensure that the protections given by the current arrangements are preserved.
- 5.4 We have also considered the timing for making our proposed changes and identified two main options:
 - implementing them at the same time as the PSD (November 2009); or

- postponing change until later (but in view of the findings of our review probably not beyond 2011) because of the wider challenges currently facing the industry, its customers and its regulators.

- 5.5 There are arguments in favour of later implementation and we recognise the challenges in delivering all the components of the new framework. However, we believe that delivery is feasible and have decided to propose implementation in November 2009. For many firms affected by the proposed banking COB framework, amendments in terms and conditions and systems will be required in any case by the PSD and our CBA work has indicated there may be some lower one-off costs for many of these firms in making both sets of changes at the same time. Moreover, if a decision in principle to change the current arrangements is taken, a lengthy lead-in period could potentially undermine consumer protection.
- 5.6 Transitional provisions would be possible for the BCOBS requirements (other than for those being transferred from COBS, some of which implement European requirements) provided that these did not create a gap in consumer protection during the transition from the current arrangements. We would welcome respondents' views on what transitional provisions they consider desirable and practicable. We would consult later on these, together with consequential changes to the Handbook.

Q9: Do you agree that the proposed new framework should come into effect at the same time as the PSD in November 2009?

Q10: In which areas do you think transitional provisions would be desirable and for how long?

- 5.7 The closing date for responses to this CP is 16 February 2009. During the consultation period we plan to hold events in London, Leeds and Edinburgh to explain our proposals (including the linkage with PSD implementation) and seek feedback. We will advertise these on our Events webpage.

Help for the industry

- 5.8 If, in the light of the consultation responses, we decide to make any changes to the current arrangements, we would work closely with the Code Sponsors, the BCSB and the OFT to achieve a smooth transition.
- 5.9 Once all the elements of the proposed new regime had been finalised, we would develop material to help firms understand the interaction between its various elements and how they would apply in practice.
- 5.10 In addition, as indicated earlier, in February 2009 we will be publishing our Approach Document to PSD implementation. We would also produce e-learning material, which we would make available externally, and organise presentations and (if necessary) training workshops for the industry and their advisers. These would be integrated where appropriate with our communications strategy for PSD implementation.

Further detail on the current self-regulatory arrangements

1. As indicated in Chapter 2, this Annex sets out some further detail on the current arrangements for the regulation of the conduct of deposit-taking activities within the self-regulatory framework of the Banking Codes. This includes more information about the content of the two Codes and the process to review and update them; further detail on the approach and supervisory tools of the Banking Code Standards Board (BCSB), and the BCSB's relationships with other relevant bodies.³⁷

The Codes

2. As Chapter 2 explains, there are two Banking Codes. The Banking Code covers dealings with personal customers, and is now in its eighth edition (the latest edition introduced in March 2008). The Business Banking Code covers business customers (see below) and is now in its fourth edition (the latest also in March 2008).

The Banking Code

3. The Banking Code aims to set standards of good banking practice for financial institutions to follow when they are dealing with personal customers in the UK. It applies to:
 - current accounts, including basic bank accounts;
 - savings and deposit accounts (including cash deposit ISAs and cash deposit Child Trust Funds);
 - payment services, including foreign-exchange services;
 - credit/debit cards and PINs; and
 - loans and overdrafts.
4. The Code does not cover mortgages, investments, insurance, Premium Bonds or currency accounts.

³⁷ Further information can also be found through the website of the BCSB and the organisations that sponsor the Banking Codes. The BCSB's website address is: www.bankingcode.org.uk

The Business Banking Code

5. The Business Banking Code aims to do the same in respect of financial institutions' business customers in the UK, with its provisions consistent with the Banking Code but tailored to these customers in terms of content and scope³⁸. It applies to:
 - current accounts;
 - deposit accounts;
 - merchant services;
 - payment systems, including services and international payments;
 - cards and PINs; and
 - business loans and overdrafts.
6. The Business Banking Code does not apply to currency accounts, factoring (invoice services), leasing, asset finance, hire purchase, investments or insurance.

Guidance and other requirements for subscribers

7. Guidance for each of the Codes is issued by the Code Sponsors as an aid to understanding and implementing the Codes. The intention is that Guidance represents general interpretations of the Codes, which may be used by the BCSB, the Financial Ombudsman Service (FOS) and others in determining industry standards. A breach of Code Guidance can render a Code subscriber liable to enforcement action.
8. In addition, the BBA and BSA have produced and maintain the Code of Conduct for the Advertising of Interest Bearing Accounts (CCAIBA). This is prepared in consultation with an industry working party and compliance with it is monitored by the BCSB.
9. The contractual relationship between the BCSB and subscribers, including its compliance policy and disciplinary processes, are set out in the Banking Code Rules, which were last updated in July 2008 to take account of the MOU signed between the BCSB and the FSA (see below). The Codes, associated Guidance, the CCAIBA and the Banking Code Rules are all enforceable by the BCSB.

The Code review process

10. As noted in Chapter 2, both Banking Codes are reviewed periodically. The primary intention of this is to consider whether the Codes (and the associated Guidance) continue to reflect market developments and innovations, relevant changes in the wider regulatory environment, and any new customer issues that have arisen which are not adequately addressed by the Codes as they stand. The Codes are currently reviewed every three years, and the last three reviews have been led by an external independent reviewer appointed by the Sponsors.

38 The population of 'business customers' covers sole traders, partnerships, limited liability partnerships, and limited companies with an annual turnover of under £1 million, as well as associations, charities and clubs with an annual income of under £1 million.

11. In summary, the review process now involves:
 - a public invitation from the reviewer to a wide range of key stakeholders³⁹ to provide views through written submissions; followed up with bilateral meetings with a number of respondents;
 - consultative round table meetings to explore further key issues and themes arising; then to discuss the reviewer's initial recommendations;
 - the reviewer makes her/his recommendations for changes to the Codes to the Code Sponsors;
 - the Sponsors (including their members) consider the recommendations and publicly respond to each (accepting or rejecting each) ahead of the publication of the revised versions of the Codes;
 - the reviewer's recommendations and the Sponsors' responses are published on the websites of each of the Sponsors; and
 - agreed and accepted recommendations are reflected in the revised versions of the Codes and associated Guidance, with transitional periods where appropriate.
12. The most recent Review of the Codes took place in 2007. The independent reviewer made 53 recommendations, around 70% of which were accepted by the Code Sponsors wholly or in part.
13. Current arrangements also provide for independent Interim Reviews/updates of the Codes, sooner than the next scheduled full review, in the event of material consumer detriment being identified that is not covered at all in the Code. Such reviews may be initiated either by the Sponsors or the BCSB. The BCSB Board can also suggest amendments/additions to the Guidance at any time.

The BCSB

14. As Chapter 2 explains, the Banking Code Standards Board was formed in 1999. As stated in its Annual Reports and other public material, its key objectives are to:
 - assist financial service firms to interpret and meet the requirements of the Banking and Business Banking Codes;
 - monitor and enforce compliance with the Codes and take disciplinary action for material breaches;
 - identify any gaps and deficiencies in the Codes that could lead to consumer detriment and to advocate change; and
 - ensure all significant providers of retail banking services subscribe to the Codes.
15. The BCSB comprises a Board of Directors and an Executive. The Board currently consists of nine directors: an independent chairman, four public interest directors, the chief executives of the three sponsoring trade bodies and the Chief Executive of the BCSB. The Board meets approximately eight times a year. Board Committees include

³⁹ Including consumer groups and organisations, firms, regulators, government departments and individuals.

an independently chaired Disciplinary Sub-committee, along with Audit & Finance, Remuneration and Communications committees. Among other things, monthly reports are made to the Board by the Executive, covering monitoring, compliance and enforcement issues.

16. As at 30 September 2008, the BCSB Executive comprises 16 staff, including a Chief Executive, Head of Compliance Monitoring, seven relationship managers, enforcement and legal personnel, and three helpdesk managers.
17. The BCSB is funded by fees paid by subscribers, and it reviews its budget annually. For the year 2007/08 its income was £1,503,277 (and retained profit for the year to 31 March 2008 was £111,805).

Monitoring

18. The BCSB took monitoring of the Banking Codes 'in-house' from the accountancy/consultancy firm of PricewaterhouseCoopers in 2001. The BCSB takes a risk-based and proportionate approach to monitoring, concentrating on, and allocating its resources to, those areas which its analysis suggests have the greatest potential for consumer detriment⁴⁰. Its stated aim is 'to ensure full adherence both to the letter and spirit of the Codes and when things do go wrong that early corrective action is taken and consumers are not disadvantaged.'⁴¹ It seeks to promote good practice and to support good compliance, consistent with its objective 'to assist financial service firms to interpret and meet the requirements of the Codes.'
19. The BCSB assigns each subscriber firm a risk profile and significance rating (Red, Amber or Green). Risk assessment involves a consideration of impact (size of firm, number of customers and products) and probability (drawing on assessments of past experience), with various inputs and sources of information/intelligence informing each assessment. Ratings are kept under review and formally reviewed at least every quarter. A firm's rating will determine the level of monitoring undertaken (including, for example, frequency of formal visits and full compliance reviews). Each of the BCSB's Relationship Managers oversees a portfolio of subscriber firms (around 20 firms), each deliberately including a range of large and small firms.
20. The BCSB's monitoring activity employs a range of tools, including:
 - pre- and post-application reviews;
 - full subscriber review visits;
 - themed reviews;
 - Annual Statements of Compliance from firms;
 - specific investigations;
 - ongoing relationship management contact; and

40 BCSB September 2007 publication on its monitoring and enforcement activity: *Ensuring a fair deal for customers*.

41 Ibid.

- information received via the BCSB Helpdesk and from a range of other external sources including consumer bodies, the media and other regulators.
21. *Pre- and post-application reviews* – every firm that wishes to become a subscriber to the Code(s) must undergo a formal review to test that they are likely to be able to comply with the Code if ‘accepted’. BCSB staff will not accept an application until they know they will be able to recommend it to the Board. This is followed up by a further review six months after an application is approved by the Board, to ensure all commitments made have been met.
 22. *Full subscriber review visits* – these periodic visits aim to review a firm’s compliance with all aspects of the Codes, including e.g. reviews of documentation, marketing material, internal systems, discussions with management, and visits to branches and call centres. A team will thus spend between a few days (for a small subscriber) up to several weeks (for a major firm). Recommendations arising are discussed with the firm’s management and action plans agreed to address any remedial points. The largest subscribers can expect such a review every two to three years; smaller firms every 4-5 years. It conducted 30 full reviews in the 2007/08 financial year.
 23. *Themed reviews* – these involve the examination of a particular aspect of the Codes across a range of different subscribers. The main determinant of themed review work undertaken is the impact on customers of a breach of the Code in a particular area and the evidence or likelihood of it occurring. Recent reviews have covered, for example, credit assessment and financial difficulties, downgraded interest on savings accounts, the sale of packaged current accounts, and moving accounts. In the 2007/08 financial year, 39 subscribers participated in themed reviews. Summaries of findings are published on the BCSB website. Thematic work can also involve consumer surveys and mystery shopping. Recent examples of this have included testing bank/building society staff’s understanding of new clearing cycles, and further testing of the sale and opening of basic bank accounts.
 24. *Annual Statement of Compliance* – this document has to be completed by all subscribers every year and signed off by the firm’s Chief Executive and designated Code Compliance Officer. As well as self-certifying compliance by reference to each provision of the Codes, the firm must highlight any breaches that have been identified by its own internal monitoring. Where shortcomings are identified, an action plan is agreed with the subscriber and the BCSB monitors its implementation. Any serious breaches that are identified are considered for possible disciplinary action (see below).
 25. *Helpdesk* – the BCSB’s Helpdesk is available to provide help and guidance to individuals who have a banking query or are dissatisfied with the service received from their banking service provider (including advice on the complaints process and the role of the FOS). Such contacts also contribute to the BCSB’s general market and firm-specific intelligence, and can lead to further action by the BCSB. The Helpdesk received 2,421 complaints and 724 enquiries in the 2007/08 financial year (by ‘phone, email or letter).

26. The BCSB also works with consumer and advice bodies that raise possible breaches of the Code for investigation, potential gaps or deficiencies in the Codes for discussion with the Sponsors, and general market information to assist and inform monitoring and enforcement activity.

Enforcement and disciplinary action

27. Decisions concerning disciplinary or enforcement action are also taken within the BCSB's overall risk-based framework and in accordance with an internal disciplinary process that is set out in the BCSB's rules. The Board's Compliance Policy states that 'many, and hopefully most, instances of non-compliance will be resolved through dialogue without resorting to formal enforcement or disciplinary action.' The BCSB has also explained publicly⁴² that the infringements it identifies 'are mostly of a minor or technical nature, often resulting from simple, unintentional mistakes or problems resulting from legacy systems with minimal customer detriment. All such cases are considered by the BCSB Executive and corrective action agreed with the subscriber, sometimes at considerable cost to them.'
28. Where issues arise, initial investigations will be undertaken by the relevant BCSB relationship manager. If it is decided that there is a case to answer, further investigation and preparation of cases for disciplinary or enforcement action will be led by the Enforcement and Regulatory Affairs Director.
29. In line with the BCSB's disciplinary process, material breaches of the Codes and/or Guidance are reported to the Board for enforcement action. Though involving an element of judgement by the BCSB Executive, the criteria for a material breach, as outlined in the Compliance Policy, include:
- the extent of actual or potential customer harm;
 - whether the problem was isolated or systemic;
 - whether the breach was inadvertent, or represented a knowing act of commission or omission;
 - the length of time over which the breach continued undetected or without effective remedial action being taken;
 - whether there were any warning signals, such as concerns expressed in the media, customer complaints, or guidance from the BCSB, and what heed was paid to such signals;
 - the extent of damage to confidence in, or the reputation of, the banking industry at large; and
 - the extent to which the subscriber sought to profit, or to avoid or mitigate a loss, by its actions or omissions.

42 *Ensuring a fair deal for customers*, September 2007

30. Where a material breach of the Codes is identified, the BCSB's disciplinary process will generally involve a hearing before the (independently chaired) Disciplinary Sub-committee of the Board which will consider the case and determine any sanction. Sanctions available to the BCSB for material breaches are:
- publication in the BCSB Annual Report;
 - a direction on future conduct;
 - a recommendation on remedy of past conduct;
 - Board warning or reprimand;
 - public censure; or
 - cancellation or suspension of registration.
31. The Disciplinary sub-committee can make a recommendation for customer redress and compensation where appropriate (in practice, all such recommendations have been actioned by the firms concerned). The BCSB does not have the power to levy fines.⁴³ Subscribers have the right to refer a decision to the BCSB Review Committee, which is independent of the BCSB Board and whose members are drawn from a panel of external legal and industry experts.
32. The BCSB's Annual Report reports that for the 2007/08 financial year no serious breaches of the Codes were identified (i.e. no breaches that caused widespread or systematic customer detriment). Investigations were carried out on six topics, involving 17 subscribers. During the year, 29 cases were identified involving breaches judged to be more than minor or purely technical but not serious enough to warrant formal disciplinary action. These were dealt with by means of the BCSB's 'remedial action agreed by executive' tool. 11 further breaches were identified from firms' Annual Statements of Compliance and addressed in the same way. Two cases were referred to the Disciplinary Sub-Committee of the Board, but were not deemed serious enough to warrant sanctions. In all cases, action plans to remedy identified breaches were monitored by the BCSB.
33. Tools which can be used to communicate issues, findings and outcomes which may be relevant to the wider subscriber population include the BCSB's regular Bulletins and 'Dear Code Compliance Officer' letters to subscriber firms. Issues are also discussed in the course of routine contacts between firms and their relationship managers, and at BCSB roadshows for subscribers.

Relationships with other relevant bodies

34. The BCSB has stated⁴⁴ that 'for the benefit of both the banking industry and its customers, we work closely with other regulators, particularly the Financial Services Authority and the Office of Fair Trading. The aim of the co-operation is to prevent either gaps in regulatory coverage or unnecessary duplication.' The BCSB's rules therefore provide for 'gateways' allowing information exchange with relevant other regulators.

43 The Board does have the option to seek the power to fine subscribers, subject to following due process for amending the Banking Code Rules to provide for this.

44 See the BCSB website at www.bankingcode.org.uk

35. In June 2008 the BCSB entered into an MOU with the FSA, setting out the arrangements for cooperation in relation to deposit products that are covered by the Banking Codes. The MOU sets out respective roles and responsibilities, including specific areas where the BCSB currently monitors on behalf of the FSA. Areas covered by the MOU include relevant FSA COBS rules, the Unfair Terms in Consumer Contracts Regulations and the Consumer Protection from Unfair Trading Regulations. The MOU also sets out the gateways for communications between the regulators on matters of mutual interest.
36. The BCSB is also an ‘approved body’ under the Northern Ireland PCA Banking Market Investigation Order 2008 and provides compliance reports in respect of the requirements of the Order to the affected banks (for submission by the banks to the Office of Fair Trading as required by the Order).
37. The BCSB also maintains close contact with the FOS, with whom it has an agreed Statement of roles and responsibilities. The FOS can consider complaints from eligible complainants relating to banking business, including in respect of deposit-taking activities, loans and credit, and credit cards.
38. The BCSB also has arrangements with the Advertising Standards Authority (ASA) under which complaints to the ASA about advertisements for products covered by the Banking Code are passed to the BCSB for investigation and any relevant enforcement action.

Cost benefit analysis

Introduction

1. This Annex sets out a market and regulatory failure analysis of the retail banking market in the UK, and a cost benefit analysis (CBA) of the proposed new framework described in this CP. Our CBA assesses the incremental costs and benefits of our proposals against a baseline which includes the status quo (i.e. our current rules, and self-regulation under the Banking Codes) and also the implementation of the relevant provisions of the PSD, coming into effect in November 2009. So, where a change is driven by PSD requirements rather than our proposed new framework we do not attempt to measure incremental impacts here.⁴⁵

Market failure and regulatory failure

2. There are two types of potential failure in this market⁴⁶: market failure arising from asymmetric information (between providers and consumers); and regulatory failure arising from deficiencies in the Banking Codes and/or the ineffectiveness of the BCSB.⁴⁷ Lack of independence from the industry can contribute to this latter type of failure, which matters where consumers lack the ability to discipline the market.
3. In relation to the existence and potential size of these market and regulatory failures, most deposit products and services are relatively simple and consumers use them frequently, so information problems may not be as common or serious as in other markets such as the retail investment market. Chapter 3 of this CP reports the findings of our review of the current arrangements, which suggest that the Codes' focus is broadly correct and that the BCSB is an effective regulator in a number of respects.
4. However, we have also found deficiencies in these current arrangements, and other evidence, in addition, shows problems which can be indicative of failures. For example, the OFT market study finds a lack of transparency on pricing of relevant products and

⁴⁵ The same is true of other possible changes whose detail may be driven by government proposals rather than our new framework, including for example requirements relating to dormant accounts or the future activities of credit unions. The Treasury published an impact assessment for the PSD in its consultation on the draft legislation issued in July 2008.

⁴⁶ That is, relevant to conduct of business rather than prudential/capital issues

⁴⁷ Strictly speaking ineffectiveness of self-regulation could be considered indicative of market failure rather than regulatory failure, but we have chosen to use a different categorisation here.

services, which may impact particularly on lower income consumers. There is also evidence of consumers choosing less appropriate products and services (particularly those consumers whose needs would be met by basic bank accounts); and some detriment also arising from the post-purchase quality of service (such as delays in processing cash deposit ISA transfers). Complaints (both as reported to us by firms and those received by the FOS) have increased considerably over the past four years.⁴⁸ When compared with our six Treating Customers Fairly (TCF) consumer outcomes, some deficiencies can also be seen, particularly in relation to providers of retail banking services keeping consumers appropriately informed (for example, where consumers are given a whole terms & conditions booklet after changes have been made, rather than having specific changes and their implications clearly highlighted).

5. There are unlikely to be market solutions to some of these problems. Even in a competitive market, firms may not have sufficient incentives to change their behaviour, for example to offer greater transparency around pricing, without regulatory intervention.⁴⁹
6. In summary, this analysis suggests that: some problems observed in the market are indicative of market and regulatory failure; the majority of consumers may not be adversely affected by problems, partly due to the nature of the market; but, because of the absolute size of the market, detriment to relatively small proportions of consumers affected by regulatory and market failure can add up to large amounts. In principle, FSA intervention can usefully address these failures. However, the extent of its effectiveness is subject to the degree to which the proposed full application of the Principles and introduction of new FSA rules focus more successfully on market failures, and monitoring and enforcement more effectively deters poor behaviour.
7. We outline and consider the main proposed changes, and their potential costs and benefits, below.

Summary of key changes

8. As explained in more detail in Chapter 4 of this CP, the main changes that we are proposing are:
 - full application of the Principles to the regulated activities of accepting deposits and issuing e-money⁵⁰ (to the extent compatible with European law);
 - some new high-level rules applying to retail banking services for consumers and micro-enterprises in BCOBS;

48 In each of the half-yearly reporting periods from July 2005-June 2008 there has been a significant increase in retail banking related complaints to relevant firms as compared with the three years from July 2002-June 2005. The number of complaints has risen between 64% and 422% in a period-for-period comparison. Similarly, complaints to firms for savings accounts for the first half of 2008 outstripped savings complaints for each of the years from 2003-2006.

49 Literature suggests if enough consumers are boundedly rational, firms will shroud some easy-to-forget information even in competitive equilibrium (Xavier Gabaix and David Laibson *Shrouded Attributes, Consumer Myopia, and Information Suppression in Competitive Markets*, *Quarterly Journal of Economics*, 121 (2), May 2006.) In such circumstances, rival firms offering more transparency are unlikely to solve the market failure by increasing their market share because sophisticated consumers who might move to them will not do so because these consumers are aware that they presently benefit from cross-subsidisation.

50 References to e-money issuers in this CP do not include the 50 small e-money issuers who are exempt from authorisation and supervision by the FSA.

- replicating our existing conduct of business rules and guidance applying to deposit taking in BCOBS;
- application of the new framework to all firms undertaking deposit-taking activities and all types of accounts; and
- FSA monitoring and enforcing the new framework, integrated into our wider risk-based approach to supervising the relevant firms and groups.

Overview of the population of firms affected

9. The proposals in this CP will apply to the population of firms who carry out the regulated activity of accepting deposits (and related activities such as the provision of cheques, and moving of accounts) and issuing e-money in the retail banking market. The main categories within this population include: UK authorised banks and building societies; other UK authorised e-money issuers (electronic money institutions); credit unions⁵¹; and incoming branches of EEA credit institutions. As reported in our 2008 Annual Report this population totalled 922 firms⁵² as of 31 March 2008.
10. A small number of large banks and building societies account for a large proportion of business in the retail banking market. The bulk of incremental costs imposed by our proposed framework will fall on these firms. However, we consider that, relative to their size, larger costs (in proportional and not absolute terms) may fall on some firms who do not currently subscribe to the Banking Codes (compliance with which would go some way in meeting the requirements of our proposed framework)⁵³. While credit unions make up the majority of the non-subscriber population covered by the proposals in this CP, as explained later in this chapter, we do not expect significant ongoing costs to be incurred by firms of this type.

Data

11. Data which informs this CBA has in the main come from the following sources of information:
 - responses to an FSA survey in September 2008 aimed at gathering information on the likely impacts of our proposed changes, sent out to a sample of banks, building societies, and industry bodies representing credit unions;
 - discussions with the BCSB and the Code Sponsors;
 - discussions with consumer groups; and

51 All references to deposit takers and credit unions exclude credit unions in Northern Ireland, which are not regulated by the FSA.

52 This is made up of 236 UK authorised banks (including wholesale only banks), 59 UK authorised building societies, 14 UK authorised e-money issuers (other than banks and building societies), 529 credit unions, and 84 branches of EEA credit institutions.

53 These are in the main some smaller building societies, some private banks, and some incoming EEA branches. A response by a large non-subscriber private bank surveyed, however, estimated no material costs from our proposals, indicating even in relative terms costs may not be all that high for non-subscribers.

- the OFT's market study on personal current accounts and further discussion with OFT representatives.
12. The main basis for cost estimates in this Annex is the survey referred to above. Responses to the survey were received from 15 firms and 4 trade associations. While these numbers are small relative to the total population of firms affected: (i) five of the largest six banks in the population, representing around 70% of market share, responded; and (ii) four out of five credit union trade associations also replied, covering most of that group.
 13. Despite this, there is still a considerable degree of uncertainty over cost estimates based on this survey. First, because of perimeter issues around the definition of a 'payment account' in the PSD which has not yet been finalised in Europe, it was not possible to define precisely the additional element of regulation in the proposed new framework in the questionnaire sent to firms. So respondents found it difficult to distinguish PSD-driven costs from other costs that might arise from the proposed new framework. Second, on some points only a very small number of survey respondents were able to quantify costs. Third, while credit unions and larger banks are well covered by our survey, results for building societies and smaller banks are based on 10 responses. These elements combined mean there may be a wide margin of error when extrapolating cost estimates based on this survey to the entire population of firms affected. For this reason, the consultation responses will be of great importance.

Costs

14. The aggregate incremental cost of the proposed new framework for the industry and the FSA across all activities is estimated to be between £3–10 million for one-off expenditures and £6–9 million on an ongoing per annum basis. The table below sets out the incremental costs by area with initial and ongoing costs shown separately. The categories noted in the table all relate to cost sources for firms, apart from direct costs to us (which will be covered by incremental fees paid by firms). These costs are presented without taking account of any cost savings, for example from any lower amounts payable to the BCSB and Code Sponsors.
15. One-off costs for firms appear quite equally divided among additional training, gap analysis, and systems needs. Our estimates suggest, if the higher ends of our ranges are more accurate, that additional training may be the most costly one-off driver. Examining the higher end of incremental on-going costs, the largest cost driver appears to be requirements around moving accounts. Many respondents expressed the view that some of these one-off costs would be lower than otherwise if implementation coincided with PSD implementation and there were sensible transitional periods.

Table: Aggregate incremental costs

One-off Costs	Estimated Minimum	Estimated Maximum
Training	£1,000,000	£4,000,000
Gap Analysis	£1,000,000	£2,500,000
Systems	£500,000	£3,000,000
Direct costs to the FSA	£500,000	
Total	£3,000,000	£10,000,000
Ongoing Costs (per year)		
Information Disclosure	£1,500,000	£2,500,000
Moving Accounts	£2,000,000	£4,000,000
Extra Compliance Staff	£300,000	£500,000
Direct costs to the FSA	£2,000,000	
Total	~ £6,000,000	£9,000,000

16. These costs are discussed in further detail in the sections below. The first of these sections describes the one-off costs listed in the table above. Part of these one-off costs will relate to the Principles being fully applied and part to other components of the proposed framework, but it is difficult for firms to apportion these costs accurately, and so we have chosen to report them in a combined section. This first section below also discusses incremental ongoing compliance costs which are also difficult for firms to disaggregate. The rest of the sections consider only incremental ongoing costs from specific elements of the framework (for example additional BCOBS requirements).

Introduction of a new framework

17. The introduction of the proposed new framework will lead to some one-off costs for firms. Firms have indicated that costs are likely to arise from:
- conducting gap analyses to ensure they are compliant with the new framework of requirements;
 - training staff to understand the new requirements and how these will affect their working practices;
 - making refinements to IT systems; and
 - communicating changes to customers.
18. We understand that, as part of conducting a gap analysis, compliance functions and legal advisers (both internal and external) may be involved. Extrapolating from information provided by the small number of firms who quantified such costs in response to our survey, and our understanding of gap analysis-related costs for

previous changes in regulation, we estimate one-off costs for the entire population of firms to be in the range of £1–2.5 million⁵⁴.

19. Firms also identify that staff would require some additional training to understand the new framework and how this changes the way they work. Different firms report this may take anywhere from an extra half an hour to an extra full day for relevant staff (in the main front line and operations centre staff). We consider a full day is likely to be an overestimate (and may only be justified if training is also being provided on PSD changes). From firms' responses to our survey we estimate one-off costs of training for all firms in the population affected to be in the range of £1–4 million⁵⁵. The bulk of this cost is the opportunity cost of staff spending time away from normal business activities.
20. A minority of firms surveyed highlighted the need to adapt IT systems to changes in requirements. A large proportion reported that incremental costs would be insignificant, minor or zero. Since we are not proposing changes to regulatory reporting requirements, in most cases adaptations should be small. Some firms (but not all) who do not subscribe to the Codes have specifically pointed out systems-related costs are of relevance to them. From the one firm which quantified incremental costs from this driver, we extrapolate one-off costs for the entire population of firms affected to be £0.5–3 million. However, given the lack of quantified cost estimates we cannot be confident about this estimate.
21. Some firms surveyed also mentioned they would probably need to reprint existing customer-facing literature where references exist to the old framework, and would also proactively inform customers of the changes to regulation. However, much of this will also need to be done for the purposes of PSD implementation, with or without the changes proposed for BCOBS. Additionally, some respondents said they would package necessary customer information alongside regular statements or other customer communications and that the use of transitional arrangements could help keep these costs to a minimum. Given this, we expect incremental costs of our changes to be small, although it is realistic to expect slightly higher costs than for PSD implementation alone. Were PSD and BCOBS changes to be implemented on different timeframes, BCOBS-specific costs could be expected to be higher, since customer communications could not be combined with PSD demands.
22. A small number of respondents to the survey indicated that they would likely incur incremental ongoing compliance costs under the new framework, suggesting extra compliance staff may be needed. From the one firm which quantified incremental costs from this driver, we extrapolate ongoing costs for the entire population of firms affected to be £0.3–0.5 million. Given the lack of quantified cost estimates we cannot be confident about this estimate.

54 Including costs of up to £250,000 for the population of credit unions

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Full application of all the Principles

23. Several factors suggest that full application of all the Principles should not lead to large incremental costs for firms. Firms are already subject to the Unfair Commercial Practices Directive's prohibition on treating consumers unfairly, and the Codes include a fairness commitment which covers some of the same ground for subscribers. We already apply the Principles in full to credit unions, so there is no impact for such firms. Additionally, several firms, including three of the largest four banks, have told us that they already apply our Principles (including TCF) across all their activities, implying little impact for such firms of fully applying all our Principles for retail banking services.
24. Where firms do not already apply all the Principles across their business, and to the extent that the COB Principles go beyond current requirements (for example the fairness commitment in the Banking Code) there are likely to be some incremental changes in behaviour and therefore costs. Some firms responding to our survey expressed a degree of uncertainty around the potential impact of fully applying all the Principles, stating that costs will in part depend on our expectations and interpretation of the standards required.
25. While firms' responses indicate that in the main these are likely to be one-off costs (which we have included in the section above), we consider that there are also likely to be some incremental ongoing costs from fully applying all the Principles. Some of these might relate to additional management information and additional compliance resources (which we have estimated and reported separately), and also costs if firms need to raise standards to achieve the consumer outcomes we expect. It is difficult to state with any certainty how far apart the FSA and firms' expectations may be on this last element. While noting that there may be a difference leading to costs, no firm has quantified what the scale of this might be.

Additional BCOBS requirements

26. The two areas where the proposed new framework introduces new high-level rules are in relation to information disclosure and post-sale requirements (see Chapter 4 for an explanation of these changes). The degree to which these rules may require different behaviour than at present would drive additional costs.
27. BCOBS information disclosure requirements will be more extensive in some respects than at present. The rules, however, include no requirement on how this disclosure should occur, i.e. it would not necessarily need to be oral, as some respondents to our survey assumed. We expect the extra time it would take to open a relevant account should be minimal and certainly no more than five minutes. Based on our understanding of the number of non-payment accounts opened each year, we estimate incremental ongoing costs of £1–2.5 million in extra staff time for the entire population of firms affected. In many cases the requirements may not involve any extra time spent, suggesting costs closer to the lower end of this range (to cover other aspects of this change such as printing).

28. The main cost associated with the new provisions around post-sale requirements relates to the requirement to have a prompt and efficient service to facilitate the moving of a banking service or product (the Banking Code only covers moving of current accounts). Firms have reported that this may require them to take on additional staff to enable them to process requests to move more quickly. The size of this cost depends on the extent that individual banks currently process non-current account move requests promptly. Based on firm responses we estimate incremental ongoing costs of around £2-4 million per year.
29. When reflecting in BCOBS the existing conduct of deposit taking rules from COBS, the cancellation rights will be extended to mirror those currently given in the Code. Effectively this means that those firms that do not subscribe to the Code, many of which are credit unions, will need to provide cancellation rights to customers who open current or savings accounts. In addition, all firms that do not provide cancellation rights to micro-enterprises will be required to do so. We do not expect that this change will have any cost implications for firms as customers can already choose to close an account at any time after opening if they wish to do so.

Credit unions

30. Only one credit union subscribes to the Banking Code and unions will be exempt from the PSD regulations. However, they will be subject to the new framework proposed in this CP to the extent that it is relevant to their activities.
31. We do not expect the proposed new framework to generate material ongoing costs for credit unions as we already monitor their compliance with our Principles, and we will continue to supervise them in a risk-based and proportionate manner⁵⁶. In response to our survey, two trade bodies raised concerns about our proposals requiring their members to provide more pre-sale information or more regular statements than at present. We do not believe that the proposed additional high-level rules in BCOBS (to the extent that they apply to credit unions' activities) will require credit unions significantly to alter their current practices – including in respect of pre-sale information (where, due to the nature of credit unions' relationship with their members, they are likely already to be communicating all that our rules require), and statements (where, for example, the rules contain a specific exclusion for accounts that utilise passbooks). Our analysis of the responses suggests that the extra costs that credit unions would face would relate to training staff/volunteers in the new framework, gap analysis and the costs of any external advice. Estimates for these one-off cost drivers have been quantified in the sections above, and are included in our summary table of costs.
32. We would welcome further comment from credit unions and their representatives on the proposals in this CP in order to confirm or challenge our analysis in the light of the greater detail now provided in this CP. We are able to vary the way in which specific requirements apply to credit unions, if there is a case.

⁵⁶ Should some credit unions extend the range of services they offer members in the future, for example as a result of the Treasury's consultation on the range of credit unions' activities (*Proposals for a legislative reform order for Credit Unions and Industrial & Provident Societies in Great Britain* (July 2008)), we would expect the way that our requirements apply to change accordingly.

Monitoring and enforcement of the new framework

33. Under the proposed new framework, we would monitor all existing conduct of business requirements for both Code subscribers and non-subscribers. Among our survey respondents most current Code subscribers expressed the view that this was unlikely to change their behaviour compared to current arrangements, indicating that this would not cause significant incremental ongoing costs⁵⁷.
34. Since conduct of business regulation is different at present for non-subscribing banks and building societies, the new framework may lead to some incremental ongoing costs. Non-subscribers responding to our survey confirmed they would expect incremental costs arising from the existing FSA rules being more systematically monitored, specifically from the need to strengthen the collection of MI, but were unable to quantify costs. Because most non-subscribers are relatively small firms we would not expect our risk-based supervision to have large time-consuming implications for these firms.
35. Our enforcement powers differ from the BCSB's significantly. While the BCSB can at most publicly censure firms, we can impose unlimited fines. This may have two cost implications for firms. First, to the extent that we impose fines these will directly lead to incremental costs for firms. In first order terms this reflects a transfer, and not an overall cost, since other firms will benefit through reduced fees equal to the fines imposed. Second, our enforcement powers and actions are likely to carry a greater deterrence effect because of our greater power to punish. To the extent that this leads to a change in firm behaviour, this will bring incremental costs. Again, to the extent the change in behaviour leads to less consumer detriment this reflects, in first order effects, a transfer from firms to consumers. It is difficult to predict in advance how many enforcement actions we might take in the future, and how our action may differ from the BCSB's in practice. Therefore quantification of these impacts is not reliably possible.

Rulemaking

36. Changes to the rulemaking process under the new framework may have cost implications for both firms and us. We can expect small incremental costs to firms to the degree that time taken to review FSA proposals (including involvement in cost benefit analyses) and other regulatory material published by the FSA is greater than the time currently spent to review the Codes at each triennial review. However, this change could also lead to minor cost savings for some firms if less time is devoted than at present. It will also necessarily involve greater costs to us in terms of policy and legal staff drafting and consulting on any proposed future changes to the high-level rules. We estimate this to cost roughly £100,000 per year.

Direct costs to the FSA

37. The move to an FSA-supervised and enforced framework would generate incremental costs for us. We estimate our one-off costs will be around £0.5m. This includes training and recruitment costs. Costs will be managed because we too would aim to combine PSD and BCOBS in our training and internal communications.

⁵⁷ One large Code subscriber said it was possible there could be incremental costs because our supervisory approach to resolving issues can require greater management involvement compared to the BCSB's approach.

38. In terms of ongoing cost drivers, we do not expect to require any additional resources for monitoring financial promotions. This is also the case with respect to the supervision of small firms, e-money issuers and credit unions. For relationship-managed firms, we estimate that additional supervisors would be required to join existing teams. In total, we would expect to require on average around 17 more FTE supervisors per year across supervision teams (spanning firm-specific supervision and as a resource to draw on for thematic work), as well as extra policy development and legal support, and additional enforcement resource. We estimate that this would lead to incremental ongoing costs of around £2 million per annum⁵⁸.
39. These cost increases will result in marginally higher fees charged to all relevant firms. The overall net fee expense for current Code subscribers could be mitigated in part by any smaller amounts payable to the BCSB and Code Sponsors.

Benefits

40. Expected benefits from our proposals could include improvements in outcomes from a more consumer focused and transparent approach, intended to provide greater protection for consumers – we have a statutory objective to secure the appropriate degree of protection for consumers. Our greater enforcement powers could generate more credible deterrence. We also consider that any large resource-intensive issues are likely to be resolved more effectively under our proposed framework than under the current arrangements.
41. The OFT market study indicates there is a non-trivial level of consumer detriment in this market, but market and regulatory failures do not appear to cause detriment to the majority of consumers, suggesting limited opportunity for large aggregate benefits. There are some problems apparent in the current arrangements that we can tackle through our proposed framework, which address market failures outside the current scope of the Codes/BCSB, and by taking stronger enforcement action than the BCSB's powers allow. If our intervention effectively addresses failures, some improvements to the status quo can be expected.

Move to the Principles and risk-based supervision

42. There could be benefits for consumers from the move to the Principles (supported by some high-level rules) as the basis for the regulation and supervision of conduct of business in this area. Principles and high-level rules set standards for end-user outcomes, not just procedures and practices for providers of services and products. Where specific detailed rules do not sufficiently curtail unacceptable behaviour or prevent detriment, high-level rules can achieve improved outcomes for consumers. Consumers would also benefit from gaining the right, under Section 150 of FSMA, to take action in the courts for damages if suffering loss as a result of a firm's contravention of an FSA rule.

58 This includes the £100,000 referred to under the previous heading in respect of rulemaking.

43. As indicated earlier, a high-level consideration of our six TCF consumer outcomes in relation to retail deposit taking indicates some deficiencies in current practices, most apparent in respect of keeping consumers appropriately informed. This suggests that firms complying with our Principles should in practice lead to some benefits for consumers. However, we should not expect incremental benefits across the board from this⁵⁹. A significant proportion of firms tell us they already apply all our Principles to all their business, implying limited change, and we also know that a large majority of consumers are unlikely to be suffering significant detriment in this area because market failure is limited.
44. A further advantage of our supervisory approach is that if consumer detriment arising from market failure is established, and the outcomes desired can be achieved under existing Principles, then the flexibility inherent in such a regime should allow for detriment to be remedied more quickly (i.e. without any new rules needing to be made).
45. There may also be cost savings for firms from the flexibility available in determining how they satisfy the Principles and high-level rules. Several existing requirements under the Banking Codes would no longer be required of firms under the proposed new framework, in respect of deposit-taking activities (we cannot comment on future arrangements for activities outside our remit). These include subscribers' Annual Statements of Compliance, provision of data on changes in interest rates paid on deposits to the regulator, and compulsory newspaper advertisements. Several firms responding to our survey indicated that these changes could lead to cost savings. We estimate, based on these responses, possible cost savings in the range of £200,000 – £1.5 million per year for the entire population of firms affected.

Additional BCOBS requirements

46. The information disclosure requirements in BCOBS can help ensure that prospective non-payment account customers can make better informed purchase decisions, and do not receive information relevant to their decision too late. This would lead to consumers being better equipped to choose more appropriate products and services for their needs, assuming that improved information disclosures lead to changes in consumer behaviour⁶⁰.
47. The requirement to have a prompt and efficient service to facilitate the moving of accounts will bring some benefits for both consumers and micro-enterprises. The fact that some firms have reported significant costs arising from this provision indicates a non-trivial percentage of the market may need to review its standards in this regard. Recent complaints regarding delays in the moving of cash deposit ISAs is further evidence that standards could be improved. By removing some obstacles to moving accounts and improving the experience of those who currently move, the ability and willingness of consumers and micro-enterprises to change providers (wholly or in part) can increase competitive pressure on firms and drive them to better meet customers' needs.

⁵⁹ It will only be customers who change their behaviour, for example by choosing alternative products or services due to being better informed, who will benefit.

⁶⁰ Recent studies indicate that further information disclosure may only lead to marginal benefits for consumers (FSA *Consumer Research Report 69*).

Enforcement

48. As discussed above, we have wider enforcement powers compared to the BCSB. In addition, a comparison of the average FSA sanction compared to the average BCSB publicised sanction reveals that our actions are likely to generate 7 times more news coverage. While we cannot predict how many cases we may be able to successfully conclude a year, our greater power to penalise and the wider coverage of our actions by the press are likely to act as a bigger deterrent for misbehaving firms. This can lead to a reduction in consumer detriment, and also be beneficial to other ‘well-behaved’ firms in the market.

Scope

49. The proposed new framework would be compulsory for all relevant firms accepting deposits and issuing e-money in the UK. It would therefore cover a wider range of firms and a wider area of activity than the current arrangements under the Banking Codes, while filling any gaps generated by implementation of the PSD. There may be improved outcomes for customers of these firms, or customers holding these types of accounts, from firms improving their standards to meet our requirements.

Change in the rulemaking processes

50. There may be benefits to consumers and their advocates (in the form of more consumer-oriented rules) from a more transparent rulemaking process which is subject to full public consultation and CBA. By subjecting proposed rules to our process and public consultation, provisions dealing with market failure are more likely to be introduced and further benefits may arise from more developed and tested requirements. We would also have the ability to propose targeted changes when and if needed. Furthermore, our outcome-focused rules represent a stronger legal basis than the current Code commitments, providing customers with a greater degree of protection regarding their expectations of treatment by firms.

Q11: Will a change to the proposed new framework generate any further costs that have not been identified here?

Q12: Will a change to the proposed new framework generate any further benefits that have not been identified here?

Q13: Do you have any other comments on our CBA?

Compatibility of proposals with our objectives and the principles of good regulation

1. This Annex sets out our assessment of the compatibility of the proposals outlined in this CP with our general duties under section 2 of FSMA and with the regulatory objectives set out in sections 3 to 6.

Compatibility with our statutory objectives

2. Our four statutory objectives are set out below, along with a description of how our proposals in this CP take account of these objectives.

Consumer protection

3. Our market and regulatory failure analysis of the current arrangements identified potential consumer detriment arising as a result of gaps in the Banking Codes' content (in particular no overarching treating customers fairly objective equivalent to FSA Principle 6), deficiencies in the process for updating the Codes, a less transparent approach to enforcement and weaker powers of sanction. The introduction of FSA COB regulation would seek to address this detriment by fully applying all the Principles (to the extent that they are compatible with European law), developing high-level rules and taking stronger enforcement action than the BCSB's powers allow.
4. The proposed changes would also allow us to apply our principle of Treating Customers Fairly across all key products in the retail market, providing consistency for consumers.
5. Retail banking customers currently have access to the FOS in order to seek resolution of individual complaints, and this would continue.
6. Section 150 of FSMA provides private persons who have suffered a loss as a result of contravention of an FSA rule with a right to take action in the courts against the authorised person concerned to secure damages for that loss. Under the current arrangements, retail banking consumers only have s150 rights in relation to issues that are covered in COBS (e.g. financial promotions). If we were to take on conduct of business regulation for deposit-taking activities, we would extend s150 rights to cover all BCOBS rules, providing further protection for consumers.

Market confidence

7. The proposals in this CP (including a consumer-focused and transparent approach, and our greater enforcement powers which we expect to generate more credible deterrence) may contribute to greater market confidence.
8. Our proposals will also improve the ability of the regulatory arrangements to respond successfully to a major emerging COB issue outside 'business as usual'. Our greater resources, ability to undertake research and analysis across the retail market, and independence from industry should mean that the market can be more confident of an effective and timely response to major emerging issues in the future.

Reducing financial crime

9. We have not identified any direct implications, though full application of the Principles as proposed may assist our work on financial crime.

Promoting public awareness

10. The proposals for the new framework include the scope for a greater range of penalties (including the ability to fine) for breaches of BCOBS or the Principles. This, combined with FSA's higher profile (compared with the BCSB), could be expected to result in more significant media attention given to breaches, which is in turn likely to go some way to improve public awareness of conduct of business issues in retail banking.
11. Requirements in BCOBS for better, timelier information provision, and the application of Principle 6 (Treating Customers Fairly) should contribute to making consumers more aware of the terms and conditions of retail deposit products and the availability of alternatives.

Principles of good regulation

12. Section 2(3) of FSMA requires that, in carrying out our general functions, we have regard to the principles of good regulation. While we have had regard to all the principles, the most relevant are set out below.

The need to use our resources in the most efficient and economic way

13. We already supervise retail deposit-taking firms from a prudential perspective, monitor and/or enforce some conduct of business requirements, and from November 2009 will be supervising and enforcing conduct of business regulation of payment service providers under the PSD. The proposals within this CP to expand our role to include all conduct of business regulation for retail deposit taking would benefit from economies of scale and scope, and the cost of taking on these new responsibilities is manageable. Some supervision would be absorbed within existing resources and existing activity (e.g. monitoring general compliance with the Principles, particularly TCF, and supervising financial promotions). There would, however, be additional costs associated with additional supervisors (undertaking both thematic and firm specific work), though we would benefit from being able to take a more holistic view

of the retail market and to more efficiently identify emerging issues or issues outside our current focus.

The responsibilities of those who manage the affairs of authorised persons

14. Within our existing emphasis on senior management responsibilities, our proposals would involve placing greater responsibility on Boards, Chief Executives and senior management teams for determining how to deploy their resources in the most effective way to achieve defined regulatory outcomes.

The restrictions we impose on the industry must be proportionate to the benefits that are expected to result from those restrictions

15. We have undertaken a cost benefit analysis (CBA) to help inform this consultation, which is detailed in Annex 2. The CBA outlines the expected costs of our proposal to both firms and the FSA, and the resulting benefits we expect. This work has been informed by pre-consultation with industry and other stakeholders.
16. As outlined in the CBA, our proposals would impose some costs on the industry. We anticipate the proposed cost to most firms of fully applying all the Principles would be relatively small, although there would be some costs to firms associated with complying with those rules in BCOBS that are new (which would vary between firms depending on their current practices and systems and, in some cases, whether or not they previously subscribed to the Banking Codes). Our approach should, however, also provide scope for cost-effective compliance by firms by allowing the alignment of regulatory compliance with business practices (as well as delivering benefits to consumers through the move to Principles as the basis for regulation and supervision).

The desirability of facilitating innovation in connection with regulated activities

17. The proposed approach should provide greater scope for innovation than the more prescriptive elements of the current arrangements (including some of the Banking Codes). Those deposit takers who do not currently subscribe to the Codes may face some new requirements but their high-level nature should not cause any reduction in the ability of these firms to innovate.

The international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom

18. Our proposals acknowledge that they are subject to current EU Directive constraints (e.g. the Payment Services Directive, Unfair Commercial Practices Directive, the Unfair Contract Terms Directive, the Distance Marketing Directive and the E-Commerce Directive). We believe that those elements of BCOBS that are not directive-driven are proportionate, of manageable additional cost, and complementary to these directives. We also consider that these changes will enhance appropriate standards in the UK market. We expect no material change to the competitive position of the UK retail deposit-taking market relative to other countries.

The need to minimise the adverse effects on competition that may arise from anything done in the discharge of those functions

19. We do not expect the proposals in the CP to have material adverse effects on competition.

The desirability of facilitating competition between those who are subject to any form of regulation by the FSA

20. The proposals to fully apply all the Principles and introduce some high-level rules will apply to all deposit-taking institutions and e-money issuers, not just those that choose to subscribe the Banking Codes as currently occurs, providing a consistent regulatory environment for all firms in the sector. However, as virtually all retail banks and building societies currently subscribe to the Code, the impact of these changes on competition is expected to be limited.
21. In one specific case we consider that competition may be facilitated. As we explain in Annex 2, additional post-sale service provisions should remove some barriers to moving accounts, enhancing competition.

Acting in a way which we consider most appropriate for the purpose of meeting our statutory objectives

22. The scope for market solutions to the problems that we have identified is limited, partly for structural reasons (i.e. self-regulation of this area is increasingly anomalous) and partly for reasons of consumer behaviour. As explained above, improving the current arrangements was considered as an option, but found not to address the key issues adequately.
23. The cost benefit analysis in Annex 2 outlines the costs and benefits of our proposals. We consider that this is the most appropriate way of meeting our statutory objectives.

Q14: Do you agree with the compatibility statement?

Consultation questions

- Q1: Do you have any comments on our analysis in Chapter 3 and our reasons for proposing a new framework?
- Q2: Do you agree with our proposal to apply all the Principles fully for all firms that accept deposits or issue e-money (Chapter 4)?
- Q3: Do you have any comments on our proposals for a Banking Conduct of Business sourcebook (Chapter 4) and the draft Handbook text in Appendix 1?
- Q4: Do you have any comments on our proposed use of the definition of micro-enterprise to cover business banking customers (Chapter 4)?
- Q5: Do you have any comments on the proposed application of BCOBS to incoming EEA branches and e-money issuers (Chapter 4)?
- Q6: Do you have any comments on the proposed application of the requirements in BCOBS to credit unions (Chapter 4)?
- Q7: Do you think there are elements of the current Banking Codes and other relevant codes/guidelines that would not appear in the PSD Regulations or BCOBS (as proposed in this CP) but which ought not to be lost?
- Q8: Do you have any comments on our proposed approach to operationalising the new framework (Chapter 4)?
- Q9: Do you agree that the proposed new framework should come into effect at the same time as the PSD in November 2009 (Chapter 5)?
- Q10: In which areas do you think transitional provisions would be desirable and for how long (Chapter 5)?

- Q11: Will a change to the proposed new framework generate any further costs that have not been identified in Annex 2?
- Q12: Will a change to the proposed new framework generate any further benefits that have not been identified in Annex 2?
- Q13: Do you have any other comments on our CBA (Annex 2)?
- Q14: Do you agree with the compatibility statement in Annex 3?

Draft Handbook text

BANKING: CONDUCT OF BUSINESS SOURCEBOOK INSTRUMENT 2009

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 139(4) (Miscellaneous ancillary matters);
 - (3) section 145 (Financial promotion rules);
 - (4) section 156 (General supplementary powers); and
 - (5) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on [2009].

Amendments to the Handbook

- D. The Glossary of definitions is amended in accordance with Annex A to this instrument.
- E. The Principles for Businesses are amended in accordance with Annex B to this instrument.

Making the Banking: Conduct of Business sourcebook (BCOBS)

- F. The Financial Services Authority makes the rules and gives the guidance in Annex C to this instrument.

Citation

- G. This instrument may be cited as the Banking: Conduct of Business Sourcebook Instrument 2009.
- H. The sourcebook in Annex C to this instrument may be cited as the Banking: Conduct of Business sourcebook (or BCOBS).

By order of the Board
[2009]

Annex A

Amendments to the Glossary of definitions

Insert the following new definitions into the appropriate alphabetical position. The text is all new and is not underlined.

banking customer in *BCOBS*:

- (1) a *consumer*;
- (2) a *micro enterprise*;
- (3) a charity which has an annual income of less than £1 million;
- (4) a trustee of a trust which has a net asset value of less than £1 million.

BCOBS the Banking: Conduct of Business sourcebook.

micro enterprise ¹ an enterprise which:

- (a) employs fewer than 10 *persons*; and
- (b) has a turnover or annual balance sheet that does not exceed €2 million.

In this definition, “enterprise” means any *person* engaged in an economic activity, irrespective of legal form and includes, in particular, self-employed *persons* and family businesses engaged in craft or other activities, and *partnerships* or associations regularly engaged in an economic activity.

[**Note:** article 4(26) of the *Payment Services Directive* and articles 1, 2(1) and 2(3) of the Annex to Recommendation 2003/361/EC]

payment service ²(in accordance with regulation 2(1) of and Schedule 1 to the *Payment Services Regulations*):

- (1) Any of the following activities when carried on as a regular occupation or business activity:
 - (a) Services enabling cash to be placed on a payment account as well as all the operations

¹ This new definition is proposed in CP08/14 “Implementation of the Payment Services Directive – Changes to the FSA Handbook.”

² This new definition is proposed in CP08/14 “Implementation of the Payment Services Directive – Changes to the FSA Handbook”.

required for operating a payment account.

- (b) Services enabling cash withdrawals from a payment account as well as all the operations required for operating a payment account.
 - (c) Execution of payment transactions, including transfers of funds on a payment account with the user's *payment service provider* or with another *payment service provider*:
 - (i) execution of direct debits, including one-off direct debits;
 - (ii) execution of payment transactions through a payment card or a similar device;
 - (iii) execution of credit transfers, including standing orders.
 - (d) Execution of payment transactions where the funds are covered by a credit line for a *payment service user*:
 - (i) execution of direct debits, including one-off direct debits;
 - (ii) execution of payment transactions through a payment card or a similar device;
 - (iii) execution of credit transfers, including standing orders.
 - (e) Issuing payment instruments and acquiring payment transactions.
 - (f) *Money remittance*.
 - (g) Execution of payment transactions where the consent of the payer to execute a payment transaction is given by means of any telecommunication, digital or IT device and the payment is made to the telecommunication, IT system or network operator, acting only as an intermediary between the *payment service user* and the supplier of the goods and services.
- (2) The following activities do not constitute payment services:

- (a) Payment transactions executed wholly in cash and directly between the payer and the payee, without any intermediary intervention.
- (b) Payment transactions between the payer and the payee through a commercial agent authorised to negotiate or conclude the sale or purchase of goods or services on behalf of the payer or the payee.
- (c) The professional physical transport of banknotes and coins, including their collection, processing and delivery.
- (d) Payment transactions consisting of non-professional cash collection and delivery for the purposes of a not-for-profit or charitable activity.
- (e) Services where cash is provided by the payee to the payer as part of a payment transaction for the purchase of goods or services following an explicit request by the payer immediately before the execution of the payment transaction.
- (f) Money exchange business consisting of cash-to-cash operations where the funds are not held on a payment account.
- (g) Payment transactions based on any of the following documents drawn on the *payment service provider* with a view to placing funds at the disposal of the payee:
 - (i) paper cheques of any kind, including travellers' cheques;
 - (ii) bankers' drafts;
 - (iii) paper-based vouchers;
 - (iv) paper postal orders.
- (h) Payment transactions carried out within a payment or securities settlement system between *payment service providers* and settlement agents, central counterparties, clearing houses, central banks or other participants in the system.
- (i) Payment transactions related to securities asset servicing, including dividends, income or other distributions, and redemption or sale, carried out by *persons* referred to in (h) or by investment firms, credit institutions, collective investment undertakings, asset management companies providing investment services or by any other entities allowed to have the custody of financial instruments.
- (j) Services provided by technical service

providers, which support the provision of payment services, without the provider entering at any time into possession of the funds to be transferred, including:

- (i) the processing and storage of data;
- (ii) trust and privacy protection services;
- (iii) data and entity authentication;
- (iv) information technology;
- (v) communication network provision; and
- (vi) the provision and maintenance of terminals and devices used for payment services.

(k) Services based on instruments that can be used to acquire goods or services only:

- (i) in or on the issuer's premises; or
- (ii) under a commercial agreement with the issuer, either within a limited network of service providers or for a limited range of goods or services,

and for these purposes the "issuer" is the person who issues the instrument in question.

(l) Payment transactions executed by means of any telecommunication, digital or IT device, where the goods or services purchased are delivered to and are to be used through a telecommunication, digital or IT device, provided that the telecommunication, digital or IT operator does not act only as an intermediary between the *payment service user* and the supplier of the goods and services.

(m) Payment transactions carried out between *payment service providers*, or their agents or *branches*, for their own account.

(n) Payment transactions between a parent undertaking and its subsidiary or between subsidiaries of the same parent undertaking, without any intermediary intervention by a payment service provider other than an undertaking belonging to the same group.

(o) Services by providers to withdraw cash by means of automated teller machines acting on behalf of one or more card issuers, which are not party to the *framework contract* with the customer withdrawing money from a payment account where no other payment service is provided.

[**Note:** articles 3 and 4(3) of, and the Annex to, the *Payment Services Directive*]

retail banking service

an arrangement with a *banking customer*, under which a *firm* agrees to accept a *deposit* from a *banking customer* on terms to be held in an account for that customer, and to provide services in relation to that *deposit* including but not limited to repayment to the customer

Annex B

Amendments to the Principles for Businesses (PRIN)

In this Annex, striking through indicates deleted text.

~~Accepting deposits and issuing electronic money~~

- 1.1.3 G The *Principles* apply with respect to ~~regulated activities~~ generally, but, in applying the *Principles* with respect to ~~accepting deposits and issuing electronic money~~ the *FSA* will proceed only in a *prudential context*. That is to say, in this context, the *FSA* would not expect to exercise the powers brought into play by a contravention of a *Principle* unless the contravention amounted to a serious or persistent violation which had implications for confidence in the *financial system*, or for the fitness and propriety of the *firm* or for the adequacy of the *firm's* financial resources.

Annex C

Banking: Conduct of Business sourcebook (BCOBS)

Insert the following new sourcebook before the Conduct of Business sourcebook (COBS) in the block of the Handbook titled “Business Standards”.

In this Annex, the text is all new and is not underlined.

1 Application

1.1 The general application rule

- 1.1.1 R This sourcebook applies to a *firm* with respect to the activity of *accepting deposits* from *banking customers* carried on from an establishment maintained by it in the *United Kingdom* and activities connected with *accepting deposits*.

Modifications to the general application rule

- 1.1.2 R The *general application rule* is modified in the chapters of this sourcebook for particular purposes.
- 1.1.3 R This sourcebook does not apply to:
- (1) *payment services*; or
 - (2) a person or *firm* which has permission for *accepting deposits* but only for the purposes of, or in the course of, an activity other than *accepting deposits*.

2 Communications with banking customers and financial promotions

2.1 Purpose and Application: Who and what?

- 2.1.1 G *Principle 6* requires a *firm* to pay due regard to the interests of its *customers* and treat them fairly. *Principle 7* requires a *firm* to pay due regard to the information needs of its *clients* and communicate information to them in a way which is clear, fair and not misleading. This chapter reinforces these requirements by requiring a *firm* to pay regard to the information needs of *banking customers* when communicating with, or making a *financial promotion*, to them and to communicate information in a way that is clear, fair and not misleading.
- 2.1.2 R In addition to the general application *rule* for this sourcebook, this chapter applies to the *communication*, or *approval for communication*, to a *person* in the *United Kingdom* of a *financial promotion* of a *retail banking service* unless it can lawfully be *communicated* by an *unauthorised* communicator without *approval*.

- 2.1.3 R This chapter applies to a *firm*:
- (1) communicating with a *banking customer* in relation to *accepting deposits*;
 - (2) communicating or approving a *financial promotion*.

2.2 The fair, clear and not misleading rule

- 2.2.1 R (1) A *firm* must take reasonable steps to ensure that a communication or a *financial promotion* is fair, clear and not misleading.
- (2) This *rule* applies in relation to:
- (a) a communication by a *firm* to a *banking customer*;
 - (b) a *financial promotion* communicated or approved by a *firm*.
- 2.2.2 G The fair, clear and not misleading *rule* applies in a way that is appropriate and proportionate taking into account the means of communication and the information that it is intended to convey. So a communication addressed to a *banking customer* who is not a *consumer* may not need to include the same information, or be presented in the same way, as a communication addressed to a *consumer*.
- 2.2.3 G The *rules* in SYSC 3 (Systems and Controls) and SYSC 4 (General organisational requirements) require a *firm* that communicates a *financial promotion* to a *banking customer* to put in place systems and controls or policies and procedures in order to comply with the *rules* in COBS 4 (Communicating with clients, including financial promotions).
- 2.2.4 G Section 397 (Misleading statements and practices) of the *Act* creates a criminal offence relating to certain misleading statements and practices.

2.3 Other general requirements for communications and financial promotions

- 2.3.1 R A *firm* must ensure that each communication made to a *banking customer* and each *financial promotion* communicated or approved by the *firm*:
- (1) includes the name of the *firm*;
 - (2) is accurate and, in particular, does not emphasise any potential benefits of a *retail banking service* without also giving a fair and prominent indication of any relevant risks;
 - (3) is sufficient for, and presented in a way that is likely to be understood by, the average *banking customer* to whom it is directed,

or by whom it is likely to be received; and

(4) does not disguise, diminish or obscure important information, statements or warnings.

- 2.3.2 G The name of the *firm* may be a trading name or shortened version of the legal name of the *firm*, provided the *banking customer* can identify the *firm* communicating the information.
- 2.3.3 G In deciding whether, and how, to communicate information to a particular target audience, a *firm* should take into account the nature of the *retail banking service*, the *banking customer's* likely or actual commitment, the likely information needs of a reasonable recipient, and the role of the communication or *financial promotion* in the sales process.
- 2.3.4 G If a communication or a *financial promotion* names the *FSA* as the regulator of a *firm* and refers to matters not regulated by the *FSA*, the *firm* should ensure that the communication or *financial promotion* makes clear that those matters are not regulated by the *FSA*.
- 2.3.5 G When communicating information, a *firm* should consider whether omission of any relevant fact will result in information given to the *banking customer* being insufficient, unclear, unfair or misleading.
- 2.3.6 G The Credit Institutions (Protection of Deposits) Regulations 1995 may apply in relation to communications with a *banking customer*.
- 2.3.7 R If a communication or a *financial promotion* compares a *retail banking service* with one or more other *retail banking service* (whether or not provided by the *firm*), the *firm* must ensure that the comparison is meaningful and presented in a fair and balanced way.
- 2.3.8 R If any information refers to a particular tax treatment or rate of interest payable, a *firm* must ensure that it prominently states that the tax treatment or the rate of interest payable depends on the individual circumstances of each *banking customer* and may be subject to change in the future.
- 2.3.9 G When designing a *financial promotion*, a *firm* may find it helpful to take account of the British Bankers Association/ Building Societies Association Code of Conduct for the Advertising of Interest Bearing Accounts.

2.4 Structured deposits, cash deposit ISAs and cash deposit CTFs

- 2.4.1 G If a *financial promotion* relates to a *structured deposit*, rules in *COBS 4.6* (Past, simulated past and future performance) will also apply.
- 2.4.2 G If a *financial promotion* relates to a *cash deposit ISA* or *cash deposit CTF*, *COBS 4.7.1R* also applies.

3 Distance communications

3.1 Distance marketing

Application

- 3.1.1 R This section applies to a *firm* that carries on any distance marketing activity from an establishment in the *United Kingdom*, with or for a *consumer* in the *United Kingdom* or another *EEA State*.

Guidance on the Distance Marketing Directive

- 3.1.2 G *Guidance* on expressions derived from the *Distance Marketing Directive* and on the Directive's application in the context of *retail banking services* can be found in *BCOBS 3 Annex 1R*.

The distance marketing disclosure rules

- 3.1.3 R A *firm* must provide a *consumer* with the distance marketing information (*BCOBS 3 Annex 1R*) in good time before the *consumer* is bound by a *distance contract* or offer.

[**Note:** article 3(1) of the *Distance Marketing Directive*]

- 3.1.4 R A *firm* must ensure that the distance marketing information, the commercial purpose of which must be made clear, is provided in a clear and comprehensible manner in a way appropriate to the means of distance communication used with due regard, in particular, to the principles of good faith in commercial transactions and the legal principles governing the protection of those who are unable to give their consent, such as minors.

[**Note:** article 3(2) of the *Distance Marketing Directive*]

- 3.1.5 R When a *firm* makes a voice telephony communication to a *consumer*, it must make its identity and the purposes of its call explicitly clear at the beginning of the conversation.

[**Note:** article 3(3)(a) of the *Distance Marketing Directive*]

- 3.1.6 R A *firm* must ensure that information on contractual obligations to be communicated to a *consumer* during the pre-contractual phase is in conformity with the contractual obligations which would result from the law presumed to be applicable to the *distance contract* if that contract is concluded.

[**Note:** article 3(4) of the *Distance Marketing Directive*]

Terms and conditions, and form

- 3.1.7 R A *firm* must communicate to the *consumer* all the contractual terms and conditions and the information referred to in the distance marketing disclosure rules (*BCOBS 3.1.1R* to *3.1.6R*) in a *durable medium* available and

accessible to the *consumer* in good time before the *consumer* is bound by any *distance contract* or offer.

[**Note:** article 5(1) of the *Distance Marketing Directive*]

- 3.1.8 G A *firm* will provide information, or communicate contractual terms and conditions, to a *consumer* if another *person* provides the information, or communicates the terms and conditions, to the *consumer* on its behalf.

Commencing performance of the distance contract

- 3.1.9 R The performance of the *distance contract* may only begin after the *consumer* has given his approval.

[**Note:** article 7 (1) of the *Distance Marketing Directive*]

Exception: successive operations

- 3.1.10 R In the case of a *distance contract* comprising an initial service agreement, followed by successive operations or a series of separate operations of the same nature performed over time, the *rules* in this chapter only apply to the initial agreement.

[**Note:** article 1(2) of the *Distance Marketing Directive*]

- 3.1.11 R (1) If there is no initial service agreement but the successive operations or separate operations of the same nature performed over time are performed between the same contractual parties, the distance marketing disclosure *rules* (BCOBS 3.1.1R to 3.1.6R) will only apply:
- (a) when the first operation is performed; and
 - (b) if no operation of the same nature is performed for more than a year, when the next operation is performed (the next operation being deemed the first in a new series of operations).

[**Note:** recital 16 and article 1(2) of the *Distance Marketing Directive*]

- (2) In this *section*:
- (a) “initial service agreement” includes the opening of a bank account;
 - (b) “operations” includes the deposit or withdrawal of funds to or from a bank account; and
 - (c) adding new elements to an initial service agreement, such as the ability to use an electronic payment instrument together with an existing *retail banking service*, does not constitute an “operation” but an additional contract to which the rules in

this chapter apply.

[**Note:** recital 17 of the *Distance Marketing Directive*]

Exception: voice telephony communications

- 3.1.12 R In the case of voice telephony communication, and subject to the explicit consent of the *consumer*, only the abbreviated distance marketing information (*BCOBS 3 Annex 2R*) needs to be provided during that communication. However, a *firm* must still provide the distance marketing information (*BCOBS 3 Annex 1R*) on a *durable medium* available and accessible to the *consumer* in good time before the *consumer* is bound by any *distance contract* or offer, unless another exception applies

[**Note:** articles 3(3)(b) and 5 (1) of the *Distance Marketing Directive*]

Exception: means of distance communication not enabling disclosure

- 3.1.13 R A *firm* may provide the distance marketing information (*BCOBS 3 Annex 1R*) and the contractual terms and conditions in a *durable medium* immediately after the conclusion of a *distance contract*, if the contract has been concluded at a *consumer's* request using a means of distance communication that does not enable the provision of that information in that form in good time before the *consumer* is bound by any *distance contract* or offer.

[**Note:** article 5(2) of the *Distance Marketing Directive*]

Consumer's right to request paper copies and change the means of communication

- 3.1.14 R At any time during the contractual relationship the *consumer* is entitled, at his request, to receive the contractual terms and conditions on paper. The *consumer* is also entitled to change the means of distance communication used unless this is incompatible with the contract concluded or the nature of the service provided.

[**Note:** article 5(3) of the *Distance Marketing Directive*]

Unsolicited services

- 3.1.15 R (1) A *firm* must not enforce, or seek to enforce, any obligations under a *distance contract* against a *consumer*, in the event of an unsolicited supply of services, the absence of a reply not constituting consent.
- (2) This *rule* does not apply to the tacit renewal of a *distance contract*.

[**Note:** article 9 of the *Distance Marketing Directive*]

Mandatory nature of a consumer's rights

- 3.1.16 R If a *consumer* purports to waive any of the *consumer's* rights created or implied by the *rules* in this section, a *firm* must not accept that waiver, nor seek to rely on or enforce it against the *consumer*.

[**Note:** article 12 of the *Distance Marketing Directive*]

Contracts governed by law of a third party state

- 3.1.17 R If a *firm* proposes to enter into a *distance contract* with a *consumer* that will be governed by the law of a country outside the *EEA*, the *firm* must *ensure* that the *consumer* will not lose the protection created by the *rules* in this chapter if the *distance contract* has a close link with the territory of one or more *EEA States*.

[**Note:** articles 12 and 16 of the *Distance Marketing Directive*]

3.2 E Commerce

Application

- 3.2.1 R This section applies to a *firm* carrying on an *electronic commerce activity* from an *establishment* in the *United Kingdom* or another *EEA State*.

Information about the firm and its products or services

- 3.2.2 R A *firm* must make at least the following information easily, directly and permanently accessible to the recipients of the *information society services* it provides:
- (1) its name;
 - (2) the geographic address at which it is established;
 - (3) the details of the *firm* including its e-mail address, which allow it to be contacted rapidly and communicated with in a direct and effective manner;
 - (4) an appropriate statutory status disclosure statement (*GEN 4 Annex 1R*), together with a statement which explains that it is on the *FSA register* and includes the *FSA register* number;
 - (5) if it is a *professional firm*, or a person regulated by the equivalent of a *designated professional body* in another *EEA State*:
 - (a) the name of the professional body (including any *designated professional body*) or similar institution with which it is registered;
 - (b) the professional title and the *EEA State* where it was granted;
 - (c) a reference to the applicable professional rules in the *EEA State* of establishment and the means to access them; and
 - (d) where the *firm* undertakes an activity that is subject to VAT, its VAT number.

[**Note:** article 5(1) of the *E-Commerce Directive*]

- 3.2.3 R If a *firm* refers to price, it must do so clearly and unambiguously, indicating whether the price is inclusive of tax and delivery costs.

[**Note:** article 5(2) of the *E-Commerce Directive*]

- 3.2.4 R A *firm* must ensure that commercial communications which are part of, or constitute, an *information society service*, comply with the following conditions:

- (1) the commercial communication must be clearly identifiable as such;
- (2) the *person* on whose behalf the commercial communication is made must be clearly identifiable;
- (3) promotional offers must be clearly identifiable as such, and the conditions that must be met to qualify for them must be easily accessible and presented clearly and unambiguously; and
- (4) promotional competitions or games must be clearly identifiable as such, and the conditions for participation must be easily accessible and presented clearly and unambiguously.

[**Note:** article 6 of the *E-Commerce Directive*]

- 3.2.5 R An unsolicited commercial communication sent by e-mail by a *firm* established in the *United Kingdom* must be identifiable clearly and unambiguously as an unsolicited commercial communication as soon as it is received by the recipient.

[**Note:** article 7(1) of the *E-Commerce Directive*]

Requirements relating to the placing and receipt of orders

- 3.2.6 R A *firm* must (except when otherwise agreed by parties who are not *consumers*):

- (1) give an *ECA recipient* at least the following information, clearly, comprehensibly and unambiguously, and prior to the order being placed by the recipient of the service:
 - (a) the different technical steps to follow to conclude the contract;
 - (b) whether or not the concluded contract will be filled in by the *firm* and whether it will be accessible;
 - (c) the technical means for identifying and correcting input errors prior to the placing of the order; and
 - (d) the languages offered for the conclusion of the contract;
- (2) indicate any relevant codes of conduct to which it subscribes and

information on how those codes can be consulted electronically;

- (3) (when an *ECA recipient* places an order through technological means) acknowledge the receipt of the recipient's order without undue delay and by electronic means; and
- (4) make available to the *ECA recipient* appropriate, effective and accessible technical means allowing the recipient to identify and correct input errors prior to the placing of an order.

[**Note:** articles 10(1) and 11(1) and (2) of the *E-Commerce Directive*]

3.2.7 R For the purposes of *BCOBS* 3.2.6(3)R, an order and an acknowledgement of receipt are deemed to be received when the parties to whom they are addressed are able to access them.

3.2.8 R Contractual terms and conditions provided by a *firm* to an *ECA recipient* must be made available in a way that allows the recipient to store and reproduce them.

[**Note:** article 10(3) of the *E-Commerce Directive*]

Exception: contract concluded by e mail

3.2.9 R The requirements relating to the placing and receipt of orders (*BCOBS* 3.2.6(3) R) do not apply to contracts concluded exclusively by exchange of e-mail or by equivalent individual communications.

[**Note:** articles 10(4) and 11(3) of the *E-Commerce Directive*]

3 Annex 1 R Distance marketing information

This Annex belongs to *BCOBS* 3.1.3R (The distance marketing disclosure rules)

Information about the firm	
(1)	The name and the main business of the <i>firm</i> , the geographical address at which it is established and any other geographical address relevant for the <i>consumer's</i> relations with the <i>firm</i> .
(2)	Where the <i>firm</i> has a representative established in the <i>consumer's EEA State</i> of residence, the name of that representative and the geographical address relevant for the <i>consumer's</i> relations with that representative.
(3)	An appropriate statutory status disclosure statement (<i>GEN</i> 4), a statement that the <i>firm</i> is on the <i>FSA Register</i> and its <i>FSA</i> registration number.
Information about the financial service	
(4)	A description of the main characteristics of the <i>retail banking service</i> the <i>firm</i> will provide.
(5)	Any limitations on the period for which the information provided is valid, including a clear explanation as to how long a <i>firm's</i> offer applies as it stands.
(6)	The arrangements for payment and performance.
(7)	Details of any specific additional cost to the <i>consumer</i> for using a means of distance communication.
Information about the contract	
(8)	The existence or absence of a right to cancel or withdraw under the cancellation rules (<i>BCOBS</i> 6) and, where there is such a right, its duration and the conditions for exercising it, including information on the amount which the <i>consumer</i> may be required to pay (or which may not be returned to the <i>consumer</i>) in accordance with those <i>rules</i> , as well as the consequences of not exercising the right to cancel or withdraw.
(9)	The minimum duration of the contract, in the case of services to be performed permanently or recurrently.
(10)	Information on any rights the parties may have to terminate the contract early or unilaterally under its terms, including any penalties imposed by the contract in such cases.
(11)	Practical instructions for exercising any right to cancel or withdraw, including the address to which any cancellation or withdrawal notice should be sent.
(12)	The <i>EEA State</i> or States whose laws are taken by the <i>firm</i> as a basis for the establishment of relations with the <i>consumer</i> prior to the conclusion of the

	contract.
(13)	Any contractual clause on the law applicable to the contract or on the competent court, or both.
(14)	In which language, or languages, the contractual terms and conditions and the other information in this Annex will be supplied, and in which language, or languages, the <i>firm</i> , with the agreement of the <i>consumer</i> , undertakes to communicate during the duration of the contract.
Information about redress	
(15)	How to complain to the <i>firm</i> , whether complaints may subsequently be referred to the <i>Financial Ombudsman Service</i> and, if so, the methods for having access to that body, together with equivalent information about any other applicable named complaints scheme.
(16)	Whether compensation may be available from the <i>compensation scheme</i> , or any other named compensation scheme, if the <i>firm</i> is unable to meet its liabilities.
[Note: Recitals 21 and 23 to, and article 3(1) of, the <i>Distance Marketing Directive</i>]	

This Annex belongs to *BCOBS* 3.1.12R

(1)	The identity of the <i>person</i> in contact with the <i>consumer</i> and his link with the <i>firm</i> .
(2)	A description of the main characteristics of the <i>retail banking service</i> .
(3)	The existence or absence of a right to cancel or withdraw in accordance with the cancellation rules (<i>BCOBS</i> 6) and, where the right to cancel or withdraw exists, its duration and the conditions for exercising it, including information on the amount the <i>consumer</i> may be required to pay on the basis of the cancellation rules.
(4)	That other information is available on request and what the nature of that information is.
[Note: article 3(3)(b) of the <i>Distance Marketing Directive</i>]	

4 Information to be provided to banking customers

4.1 Enabling banking customers to make informed decisions

The appropriate information rule

- 4.1.1 R A *firm* must provide a *banking customer* with appropriate information about a *retail banking service* and any *deposit* made in relation to that *retail banking service* in good time and in a comprehensible form so that the *banking customer* can make decisions on an informed basis.
- 4.1.2 G The appropriate information *rule* applies before a *banking customer* is bound by the terms of the contract. It also applies after a *retail banking customer* has become bound by them. In order to meet the requirements of the appropriate information *rule*, information provided by a *firm* to a *banking customer* should include information relating to:
- (1) the *firm*;
 - (2) the different types of *retail banking service* provided by the *firm* which may be of interest to the *banking customer* (either in addition to or as an alternative to any *retail banking service* with regard to which the *banking customer* has enquired, made application or entered into a contract to obtain) unless the *banking customer* has expressly indicated that he does not wish to receive it;
 - (3) (unless *BCOBS 3* applies) the terms and conditions of the contract for a *retail banking service* before a *banking customer* is bound by them and of any changes to them after a *banking customer* has become bound by the contract;
 - (4) the rate or rates of interest payable on any *deposit* and any changes to that rate or those rates;
 - (5) any costs chargeable to the *banking customer* and charges relating to the operation of each *retail banking service*;
 - (6) a *banking customer's* rights to cancel a contract for a *retail banking service*;
 - (7) how a *banking customer* may make a complaint;
 - (8) the terms of any compensation scheme if the *firm* cannot meet its obligations in respect of the *retail banking service*.
- 4.1.3 G The information required by the appropriate information *rule* may vary according to matters such as:
- (1) the *banking customer's* likely or actual commitment;
 - (2) the information needs of a reasonable recipient having regard to the

type of *retail banking service* that is proposed or provided and its overall complexity, main benefits, risks, limitations, conditions and duration;

- (3) distance communication information requirements (for example, under the distance communication *rules* less information can be given during certain telephone sales than in a sale made purely by written correspondence (see *BCOBS 3.1*)); and
- (4) whether the same information has been provided to the *banking customer* previously and, if so, when that was.

- 4.1.4 G In determining what is “in good time”, a *firm* should consider the importance of the appropriate information to the decision-making process of the *banking customer* and the point at which the information may be most useful. Distance communication timing requirements are also relevant. For example, where a *firm* proposes to make a change to the terms and conditions of a *retail banking service* which will be to the detriment of a *banking customer*, it should take into account the period of notice required by the *banking customer* to cancel the contract for the *retail banking service*.
- 4.1.5 G The existence of cancellation rights does not affect what information it is appropriate to give a *banking customer* in order to enable him to make an informed purchasing decision.
- 4.1.6 G If the *retail banking service* is a *cash deposit ISA* or a *cash deposit CTF*, the rules in *COBS 13.1* (Preparing product information) and *14.2* (Providing product information to clients) also apply.
- 4.1.7 R Where a *rule* in this chapter requires information to be provided in writing or another *durable medium* before a *banking customer* is bound by the terms and conditions of the contract, a *firm* may instead provide that information in accordance with the distance communication requirements (see *BCOBS 3.1*) (if applicable).

4.2 Statements of account

- 4.2.1 R (1) A *firm* must make available to a banking customer in a *durable medium* such regular statements of account as are appropriate to the type of *retail banking service* provided, but need not do so where:
- (a) the *firm* has provided a *banking customer* with a pass book or other document in a *durable medium* that records transactions in relation to the *retail banking service*;
 - (b) the *retail banking service* is of a type that is intended to be operated by a *banking customer* electronically by distance means and where the *banking customer* is able to view transactions in relation to the *retail banking service* electronically using distance means in real time;
 - (c) a *banking customer* has elected, whether by means of a dispensation notice given to the *firm* under section 185(2) of the Consumer Credit Act 1974 or otherwise, not to receive periodic statements of account, and for so long as such election is in force.
- (2) A *firm* must provide a *banking customer* with a duplicate copy in a *durable medium* of any statement of account provided to the *banking customer* under (1) within a reasonable period of time following a request to that effect made by or on behalf of the *banking customer* and may make a charge for this service.

5 Post sale requirements

Service

- 5.1.1 R A *firm* must provide a service in relation to a *retail banking service* which is prompt, efficient and fair to a *banking customer* and which has regard to any communications or *financial promotion* made by the *firm* to the *banking customer* from time to time.

Dealings with customers in financial difficulty

- 5.1.2 G *Principle 6* requires a *firm* to pay due regard to the interests of its customers and to treat them fairly. In particular, a *firm* is required to deal fairly with a *banking customer* whom it has reason to believe is in financial difficulty.

Moving a retail banking service

- 5.1.3 R A *firm* must provide a prompt and efficient service to enable a *banking customer* to move to a *retail banking service* provided by another *firm*.
- 5.1.4 G Where a *banking customer* wishes to move a *retail banking service* and there are no arrangements between the *firm* the *banking customer* wishes to move from and the *firm* that the *banking customer* wishes to move to, the service provided by the former *firm* will extend only to providing a prompt and efficient service in respect of termination of the *retail banking service*, for example by closing an account and returning any *deposit* (with interest as appropriate) to the *banking customer*.
- 5.1.5 G Where a *banking customer* wishes to move a *retail banking service* and there are arrangements between the *firm* the *banking customer* wishes to move from and the *firm* that the *banking customer* wishes to move to, the service provided by the former *firm* will include providing a prompt and efficient service in respect of termination of the *retail banking service*, for example by closing an account, transferring any account balance and making arrangements in respect of any direct debits or standing orders.

Lost and dormant accounts

- 5.1.6 R A *firm* must make appropriate arrangements to enable a *banking customer* to trace and, if appropriate, to have access to a *deposit* held (or formerly held) in a *retail banking service* provided by the *firm*. This applies even if:
- (1) the *banking customer* may not be able to provide the *firm* with information which is sufficient to identify the *retail banking service* concerned (a lost account); or
 - (2) the *banking customer* may not have carried out any transactions in relation to that *retail banking service* for an extended period of time (a dormant account).

- 5.1.7 R If a *firm* participates in a reclaim scheme³, it must inform a *banking customer* of this fact and provide appropriate information regarding the terms of the scheme on entering into communications with a *banking customer* regarding a lost account or a dormant account.

³ HM Treasury is proposing a voluntary scheme (the reclaim fund) that will manage bank/ building society dormant accounts. The Dormant Bank and Building Society Accounts Bill is currently before Parliament and we intend to publish a CP on implementation should the Bill receive Royal Assent. This rule may, accordingly, need to be amended to reflect the provisions of the legislation (if made).

6 Cancellation

6.1 The right to cancel

Introduction

- 6.1.1 G A *banking customer* has a right to cancel a contract for a *retail banking service* without penalty and without giving any reason, within 14 days except:
- (1) where the rate or rates of interest payable on the *deposit* are fixed for a period of time following conclusion of the contract;
 - (2) where the rate or rates of interest payable or the price depends on rises and falls in financial markets outside the control of the *firm* that may occur during the cancellation period; or
 - (3) which is a *CTF deposit account* (other than a *distance contract*).
- 6.1.2 G A *firm* may provide longer or additional cancellation rights voluntarily, but if it does these should be on terms at least as favourable to the *banking customer* as those in this *chapter*, unless the differences are clearly explained.

Beginning of cancellation period

- 6.1.3 R The cancellation period begins on the later of:
- (1) either from the day of the conclusion of the contract for the *retail banking service*; or
 - (2) from the day on which the *banking customer* received the contractual terms and conditions of the *retail banking service* and any other pre-contractual information required under this sourcebook, if that is later than the date referred to above.
- [**Note:** article 6(1) of the *Distance Marketing Directive* in relation to *distance contracts*]

Disclosing a right to cancel

- 6.1.4 R The firm must disclose to a *banking customer* in good time, or if that is not possible, immediately after the *banking customer* is bound by a contract for a *retail banking service*, and in a *durable medium* the existence of the right to cancel or withdraw, its duration and the conditions for exercising it including information on the amount which the *banking customer* may be required to pay, the consequences of not exercising it and practical instructions for exercising it, indicating the address to which the notification of cancellation or withdrawal should be sent.

6.2 Exercising the right to cancel

- 6.2.1 R If a *banking customer* exercises his right to cancel he must, before the expiry of the cancellation period, notify this following the practical instructions given to him. The deadline shall be deemed to have been observed if the notification, if in a durable medium available and accessible to the recipient, is dispatched before the cancellation period expires.

[**Note:** article 6(6) of the *Distance Marketing Directive* for distance contracts]

- 6.2.2 G The *firm* should accept any indication that the *banking customer* wishes to cancel as long as it satisfies the conditions for notification. In the event of any dispute, unless there is clear written evidence to the contrary, the *firm* should treat the date cited by the *banking customer* as the date when the notification was dispatched.

Record keeping

- 6.2.3 R The *firm* must make adequate records concerning the exercise of a right to cancel or withdraw and retain them for at least three years.

6.3 Effects of cancellation

- 6.3.1 R By exercising a right to cancel, a *banking customer* withdraws from the contract and the contract is terminated.

Payment for the service provided before cancellation

- 6.3.2 R (1) This *rule* applies in relation to a contract for a *retail banking service* that is not a *cash deposit ISA* or *CTF deposit account*.
- (2) When a *banking customer* exercises the right to cancel he may only be required to pay, without any undue delay, for the service actually provided by the *firm* in accordance with the contract. The amount payable must not:
- (a) exceed an amount which is in proportion to the extent of the service already provided in comparison with the full coverage of the contract;
 - (b) in any case be such that it could be construed as a penalty.

[**Note:** article 7(1), (2) and (3) of the *Distance Marketing Directive* in relation to *distance contracts*]

- (3) The *firm* may not require a *banking customer* to pay any amount on

the basis of this *rule* unless it can prove that the *banking customer* was duly informed about the amount payable and, in the case of a contract which is a *distance contract*, in conformity with the distance marketing disclosure rules. However, in no case may the *firm* require such payment if it has commenced the performance of the contract before expiry of the cancellation period without the *banking customer's* prior request.

[**Note:** article 7(1), (2) and (3) of the *Distance Marketing Directive* in relation to *distance contracts*.]

6.4 Obligations on cancellation

- 6.4.1 R The *firm* must, without undue delay and within 30 days, return to the *banking customer* any sums it has received from him except for any amount that the *banking customer* may be required to pay under *BCOBS* 6.2.2R. This period begins from the day on which the *firm* receives the notification of cancellation.

[**Note:** article 7(1), (2) and (3) of the *Distance Marketing Directive* in relation to *distance contracts*.]

6.5 Banking customer's obligation on cancellation

- 6.5.1 R The *firm* is entitled to receive from the *banking customer* any sums or property he has received from the *firm* without any undue delay and no later than within 30 calendar days. This period begins from the day on which the *banking customer* dispatches the notification of cancellation.

[**Note:** article 7(5) of the *Distance Marketing Directive* in relation to *distance contracts*.]

- 6.5.2 R Any sums payable under this *section* on cancellation of a contract are owed as simple contract debts and may be set off against each other.

Schedule 1

Record keeping requirements

Notes:

- 1 The aim of the *guidance* in the following table is to give the reader a quick overall view of the relevant record keeping requirements.
- 2 It is not a complete statement of those requirements and should not be relied on as if it were.

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
<i>BCOBS</i> 6.2.3R	Cancellation: exercise of right	Exercise of the right to cancel or withdraw	Date of exercise	At least three years

Schedule 2

Notification requirements

There are no requirements for notification in *BCOBS*.

Schedule 3

Fees and other required payments

There are no requirements for fees or other payments in *BCOBS*.

Schedule 4

Powers exercised

The following powers and related provisions in or under the *Act* have been exercised by the *FSA* to make the *rules* in *BCOBS*:

- section 138 (General rule-making power);
- section 139(4) (Miscellaneous ancillary matters);
- section 145 (Financial promotion rules);
- section 156 (General supplementary powers).

The following powers in the *Act* have been exercised by the *FSA* to give the *guidance* in *BCOBS*:

- section 157(1) (Guidance).

Schedule 5

Rights of action for damages

- 5.1 The table below sets out the *rules* in *BCOBS* contravention of which by an *authorised person* may be actionable under section 150 of the *Act* (Actions for damages) by a *person* who suffers loss as a result of the contravention.
- 5.2 If a “Yes” appears in the column headed “For private person?”, the *rule* may be actionable by a *private person* under section 150 (or, in certain circumstances, his fiduciary or representative; see article 6(2) and (3)(c) of the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 (SI 2001/2256)). A “Yes” in the column headed “Removed” indicates that the *FSA* has removed the right of action under section 150(2) of the *Act*. If so, a reference to the *rule* in which it is removed is also given.
- 5.3 The column headed “For other person?” indicates whether the *rule* may be actionable by a *person* other than a *private person* (or his fiduciary or representative) under article 6(2) and (3) of those Regulations. If so, an indication of the type of *person* by whom the *rule* may be actionable is given.

Rule	Right of action under section 150			
	For private person?	Removed?	For other person?	
Any rule in <i>BCOBS</i> which prohibits an authorised person from seeking to make provision excluding or restricting any duty or liability	Yes	No	Yes	Any other person
All other rules in <i>BCOBS</i>	Yes	No	No	

Schedule 6

Rules that can be waived

- 6.1 As a result of regulation 10 of the Regulatory Reform (Financial Services and Markets Act 2000) Order 2007 (SI 2007/1973) the *FSA* has power to waive all its *rules*. However, if the *rules* incorporate requirements laid down in European directives, it will not be possible for the *FSA* to grant a waiver that would be incompatible with the United Kingdom's responsibilities under those directives.

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