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Freshfields FS insights

Part 1 – Focus on Consumer Protection

As we adjust to the new “normal”, with some countries beginning to emerge from the pandemic, the recent focus on consumer protection in the financial services sector is expected to continue. In this edition, we explore the general direction of policy and enforcement action in this area and the main risks for financial institutions.

Next month, we will examine consumer protection in further detail; assessing specific areas where regulators are protecting consumers in the face of developing threats, including in the fields of cybersecurity and financial crime. We will also address the uptick in consumer-driven enforcement action and private class actions as members of the public seek to vindicate their newfound rights.

Intrusive Intervention to protect consumers

The 2008 Global Financial Crisis marked a watershed when policymakers and regulators intervened in financial markets with comprehensive regulation across several areas. More recently, law-makers have turned their attention to focus specifically on regulation to achieve greater consumer protection. Responding to (amongst other things) concerns of potential hardship arising from the pandemic and the increased participation of individuals in financial markets.

The increasing participation of individuals in financial markets is evident from consumers' involvement in crypto-assets. With recent fake news around Walmart's acceptance of crypto-currencies for payment illustrating how consumers can be easily mislead by the new forms of investment. The UK Financial Conduct Authority (FCA) reflects the concerns of many regulators, issuing warnings of the risks to consumers.

The gamification phenomena also illustrates consumers engagement in financial markets without adequate awareness of the risks. The US Securities and Exchange Commission (SEC) is examining gamification and behavioural prompts utilised by online trading platforms, further reflecting the Commission’s focus on consumer protection. In an August 27, 2021 statement, the SEC announced that it is seeking comments and information from consumer advocates and market participants concerning digital engagement practices by broker-dealers and investment advisors. The SEC is concerned that the underlying technology “is putting investors at risk by encouraging excessive trading and pushing specific stocks”. To address its concerns, the

Commission requested feedback on a number of technological features, including social networking tools that connect investors, trading platforms' notification features, prompts with investment ideas or suggestions, and reliance on chatbots to respond to traders' inquiries. The feedback would enable the SEC to better understand its role in protecting consumers from potential conflicts of interest and to determine whether the Commission should consider such features as formal investment recommendations and advice.

These and other developments has led to a proliferation of governmental and regulatory initiatives to protect consumers, which follow the trend of the G20 "building back better" in an era of political and societal change marking the return of "Big Government"

The UK Government is leading in these efforts; recently announcing reforms to competition and consumer protection laws to offer better consumer protection measures. The FCA is similarly intervening. Its 2021 Business Plan places consumers front and centre. The FCA has signalled a more aggressive and assertive approach to achieving consumer protection, including by utilising data-driven approaches to prevent misconduct. The plan notably confirms the announcement earlier this year that the FCA will introduce a far-reaching 'Consumer Duty' to achieve fairer outcomes for the public.

US regulators are also joining the efforts to protect consumers, with new faces at the main agencies taking the lead. Rohit Chopra, an experienced financial regulator with a consumer focused background, was recently appointed to head the US Consumer Financial Protection Bureau (CFPB). The CFPB has recently reported on ways in which it is intervening to protect consumers under her leadership; including within the fields of fair lending and mortgages. The Chairman of the SEC, Gary Gensler, has likewise said that the regulator will strive to protect consumers by; for example, considering its oversight authority over the sale of cryptocurrencies, proposing tough crypto-asset regulation and reviewing the practice of payment for order flow to prevent MemeStock trading that can harm consumers.

We now move to assess the collateral risks from the increased activity aimed at achieving greater consumer protection.

The Risks

Action to tackle fraud

Where there is potential for fraud directly harming consumers, regulators will actively strive to intervene. The EU has proposed a comprehensive legislative package to overhaul anti-money laundering (AML) regimes, in part, to protect consumers from financial crime. In parallel, the UK FCA is cracking down on financial crime that targets consumers. For example, the FCA instituted proceedings against an illegal money lender who targeted vulnerable customers and pursued the jailing of an exfinancial advisor for money laundering. Similarly in Asia, in recent operations, the Securities and Futures Commission (SFC) and Hong Kong Police targeted a suspected ramp-and-dump syndicate and a social media ramp-and-dump scam.

Even when financial institutions are not directly involved in alleged fraudulent conduct, they may be caught in the crossfire, such as via disclosure proceedings and enforcement action for failure to prevent offences (e.g. money laundering and tax evasion). For example, the UK Proceeds of Crime Act is similar to legislation in most G20 jurisdictions, which penalises banks for failing to disclose suspicious activity. The UK Crown Prosecution Service recently announced that an action can exist as a standalone charge; it is not necessary to prosecute the defendant or other persons for money laundering. Similarly, the FCA seems increasingly willing to initiate court proceedings for systems and controls failings that fail to prevent fraud, following a global trend of stricter AML regulation and enforcement. One such example is the landmark criminal proceedings that the FCA launched against a retail bank for inadequate controls that failed to prevent underlying financial crime.

Regulating financial products

Of particular relevance to financial institutions, regulators and policy-makers are also focusing on consumer protection through increased oversight of financial products. Resulting in firms facing potential enforcement action based on different levels of failings; ranging from inadequate disclosure and product governance, to unfair pricing of financial products.

Promoting Greater Transparency

The EU has spearheaded disclosure requirements on firms, for example, as illustrated by directives in the field of consumer credit agreements and consumer mortgages, and the European

Banking Authority's (EBA) Opinion on disclosure requirements related to consumers buying financial services through digital channels. More recently, the EU Commission published a proposal for a revised EU Consumer Credit Directive, which requires that “credit offers are presented to consumers in a clear way easily readable on digital devices”. The approach of the EU has resulted in questions of whether the current rules for disclosure are still fit for purpose. The US SEC is also considering strengthening special purpose acquisition company (SPAC) disclosures, especially around dilution, amid concerns that the new forms of investment offer inadequate protection to consumers.

Product Governance

Product governance is progressively regulated to protect consumers across leading nations. For example, the European Banking Authority (EBA’)s, the European Insurance Occupational Pensions Authority (EIOPA)'s and the European Securities and Markets Authority (ESMA)'s Product Intervention Powers entitle these regulators to prohibit or restrict the marketing, distribution and/or sale of certain financial investments across EU member states. The China Banking and Insurance Regulatory Commission has similarly issued reforms for the protection of consumer rights and interests and the People’s Bank of China has published measures for financial consumer protection. The rules prescribe extensive new requirements for financial instruments, which are aimed to protect consumers. In addition, the UK FCA is implementing new product governance rules to ensure that insurance products provide fair value.

Price Intervention

Some of the most intrusive intervention by regulatory authorities is evident from requirements to achieve fairer pricing. The EU Payment Accounts Directive introduced the right to a basic payment account, as well as regulating the pricing for such accounts. The FCA's novel Consumer Duty will similarly require that the price of accounts services and products represent "fair value for consumers". However, as a consequence of the new FCA requirements, firms are left wondering how the various layers of new and existing obligations intersect to shape their duties to consumers; creating concerns of confusion. Competition regulators globally are likewise aiming to achieve a "reset" of competition regimes to address perceived consolidation and concentration in markets that unfairly increases prices for consumers.

Policymakers and regulators have increased their focus on consumer protection, responding (among other things) to concerns about potential hardship arising from the COVID-19 pandemic and the increased participation of individuals in financial markets

New asset class challenges

The new challenges from emerging asset classes that pose risks of harm to consumers are resulting in regulators struggling to keep pace with developments, particularly in respect of crypto-assets. These have the potential to harm consumers and consequently are attracting greater attention from policymakers globally:

- The EU's proposed AML overhaul will combat the increasing use of crypto-assets in money-laundering schemes. The measures include applying the "travel rule" also to crypto-assets transfers to require greater transparency on the details of the transferring parties to transactions;
- The US FTC and State Attorneys General have warned consumers of the threats of crypto-scams, in turn incentivising regulators to tackle challenges for consumers posed by crypto-assets. The SEC Chair voiced support for regulations

addressing the links between crypto-assets and "fraud, scams and abuse";

- Following a consultation on a licensing regime for virtual asset services providers, the Hong Kong Government recently announced that it intends to implement the proposals to require registration in this area; and
- The UK Treasury has consulted on extending the existing regulatory perimeter to crypto-assets. It discusses first introducing a regulatory regime for stable tokens used as a means of payment and then in the longer term to consider a broader set of crypto-asset market actors or tokens. The consultation acknowledged FCA data illustrating the risks to consumers from price volatility and a lack of understanding of the products on offer. The UK FCA has nonetheless acknowledged that it is powerless to address many of the risks related to crypto-assets, for example in relation to Binance crypto-exchange.

Digital Currencies as a Viable Safe Alternative?

The leading Central Banks are considering digital currencies as a potential alternative to safeguard against perceived crypto-currency threats:

- US FED Chair Powell announced that the Federal Reserve will publish a discussion paper on the benefits and costs of creating a Central Bank Digital Currencies ("CBDC");
- The Bank for International Settlements has released part of its Annual Economic Report noting the benefits of CBDC;
- Having concluded that crypto-assets do pose risks to investors; the Bank of England is considering a digital currency; and
- The EU's plans for a digital euro move to the next phase.

Even if such plans culminate in final policies, there are marked differences between digital currencies and crypto-currencies, which may not make digital currencies viable substitutes.

Consumers at the top of the Agenda

The recent trends discussed in this edition show that consumer protection continues to be an important focus area across the financial services landscape worldwide, which we will explore in greater detail next month.

In the meantime, for additional insight on other notable topics in the financial services sector, you may review our earlier editions here, including on political and societal change, technological transformation (covering the GameStop saga and the wider implications of technological change), and financial crime.

If you would like to provide feedback on this or other editions, please contact Laura Feldman.