Tools for Culture Change: FCA, now you are listening! Time to build an independent, low cost forum for conduct dispute resolution

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Key points

- Following January's article entitled 'Tools for Changing Banking Culture: FCA Are You Listening?' (2016) 11(2) *Capital Markets Law Journal* 129 (in which this author criticised the FCA's ad hoc swaps mass redress system and suggested the FCA set up a standing financial services disputes tribunal modelled on the Employment Tribunals) Dr Bailey, the new CEO of the Financial Conduct Authority (FCA), accepted that its administrative ad hoc mass redress schemes have not been successful, in particular for swaps.
- Dr Bailey has now accepted the principle that the FCA should empower an independent entity to resolve disputes between banks and consumers and should not seek to involve itself in their determination. He is considering his options.
- This article analyses how and why the FCA over-extended itself by entering the arena of dispute resolution. It explores why the FCA's efforts failed to satisfy market participants and undermined the confidence needed for retail markets to function efficiently—in particular by creating the impression of corporatism.
- The article explains how and why common law dispute resolution systems generate market confidence. It also notes that the department of state behind the success of the common-law-based Employment Tribunals 50 years ago—now called Business, Energy and Industrial Strategy—has recently applied the same common law principles for dispute resolution in service of its competition objective by expanding the Competition Appeal Tribunal.
- The article concludes by suggesting that the FCA should endow its independent dispute resolution authority with the same common law characteristics. It suggests three ways the FCA might do so.

1. Regulatory overreach—the FCA's mass-redress error

On 1 February 2016, in the Chamber of the House of Commons, MPs debated a motion of no confidence[1] in the Financial Conduct Authority (FCA). On 20 July 2016, the new Chief Executive Officer of the FCA, Dr Andrew Bailey, gave evidence[2] before the Treasury Select Committee. In his evidence he observed that the a good deal of the no confidence

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1 See <http://www.publications.parliament.uk/pa/cm201516/cmhansrd/cm160201/debtext/160201-0003.htm> accessed 29 November 2016.

2 See <http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/treasury-committee/appointment-of-andrew-bailey-as-chief-executive-officer-of-the-financial-conduct-authority/oral/35279.pdf> accessed 29 November 2016.

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debate centred 'around cases that involve those adjudication processes'[3]—such as the swap mass redress system. He also said this:

> I do not think the FCA was really established or conceived to be an adjudication body. It is a regulatory or supervisory body. Now, this is not a criticism, but it has found itself in that role, and it has found itself creating–I do not know how many, but there are quite a few–bespoke adjudication processes. . . .[4]
> For interest rate hedging products, it has created a process by which the banks have a duty to do the process and there is oversight by a so-called skilled person, which is typically an accounting firm. That is enormously controversial. . . .[5]
> I do not think this practice of creating–I use this term carefully, because it is a bit pejorative, but you know the point I am making–ad hoc processes has been, frankly, in my view, a success. . . .[6]
> The question that follows for me is: given we have to have adjudication processes, how do we get to a point where we have better established processes with more authority and, frankly, where people can reasonably feel–I use this as a metaphor–not literally–'I have had my day in court.' The point is that the process has enough authority, in the best sense of the term, to it that I accept that it was a process that got me to judgment, even if I do not like the end point of it.[7]
> . . . I am going to look at this question. This is not the FOS by the way; this is the non-FOS bit I am talking about now. . . . I do not yet know what the alternative is. If you do not mind, I need some time to think about it.[8]

As Dr Bailey explained to the Select Committee, the FCA's campaign of designing and running mass redress systems was an example of mission creep; of regulatory overreach. Dr Bailey has appreciated the need for the FCA to step back from direct involvement in adjudication and for it to pursue its policy objectives in that realm by different means. This author agrees with his diagnosis of the problem.[9] This article seeks to be of assistance to Dr Bailey in finding a solution.

2. From light to heavy-touch regulation—three characteristics

How was it that the FCA came to overreach itself in this way? In the view of this author, the FCA simply believed itself to be taking what appeared to it to be the next logical step in the direction of travel, which began in reaction to the free-market 1980s[10] and which greatly accelerated after 2008: from light-touch to heavy-touch regulation.[11] To make that contention good, one must briefly consider what one means by those terms.

3 Reply to Q32 para 3, lines 8–9.

4 ibid para 3, lines 1–6.

5 ibid para 2, lines 7–10.

6 Reply to Q34 para 1, lines 5–7.

7 Reply to Q32 para 4.

8 Reply to Q34 para 1, lines 1–2 and Reply to Q35.

9 It underpinned this author's Tools for Changing Banking Culture: FCA Are You Listening? Why the FCA's IRHP Mass Dispute Resolution System Has Failed and What the FCA Can Do About It' (2016) 11(2) Capital Markets Law Journal 129.

10 For expansion of neo-liberalist ideas during the 1970s and 1980s, see, eg Daniel Stedman Jones, *Masters of the Universe: Hayek, Friedman, and the Birth of Neoliberal Politics* (Princeton UP 2012) 1–20.

11 See, eg: FSA Chief Executive, Hector Sants, 'the FSA's new approach ''will certainly no longer be seen as light touch!''' , 9 November 2009 <http://www.fsa.gov.uk/library/communication/speeches/2009/1109_hs.shtml> accessed 29 November 2016; 'The Turner Review: A Regulatory Response to the Global Financial Crisis', March 2009, 86ff <http://www.fsa.gov.uk/pubs/other/turner_review.pdf> accessed 29 November 2016; Jennifer Hughes, 'FSA to Step up Its Supervisory Role', *Financial Times* (30 November 2008) <http://www.ft.com/cms/s/0/63c0b9c6-bf2b-11dd-ae63-0000779fd18c.html#axzz4K7wcdDCf> accessed 29 November 2016; Harry Wilson, The Telegraph, 'Hector Sants calls time on FSA's 'light touch' regulation' 12 March 2010 <http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/7431645/Hector-Sants-calls-time-on-FSAs-light-touch-

First, then, let us consider how light touch regulation in this country—and in the anglo phone countries which derive their traditions from this country—actually worked. The legal point of departure is that all markets are free:[12] not all markets need be regulated; freedom to contract is one of the basic freedoms we enjoy under the common law.[13] However, neither consumers nor suppliers have been content for all markets to be free. Certain markets[14] are considered to merit a barrier to entry before suppliers may enter. This is principally because the imbalance of knowledge and resources between supplier and purchaser[15] can result in supplier abuse at the point of sale. This results in a collapse in consumer confidence and volumes, which is in neither consumers' nor suppliers' interests.

Initially, it was the suppliers themselves—wishing to maintain market confidence and volumes—well before the 'big state',[16] of which the FCA is part, developed in the twentieth century—who, by self-regulation,[17] erected the necessary barrier to entry. The barrier normally amounted to ensuring a supplier had completed minimum standards of training and was certified as a 'fit and proper person' or its equivalent. In the language of Financial Services and Markets Act (FSMA2000),[18] the professions pursued the 'consumer protection' and 'integrity' objectives of their own accord.

Such guild-like self-regulation is the very definition of the 'light touch' regulation. But it would be a fallacy to suppose that light-touch regulation simply left the market to operate in a vacuum once the barrier to entry was surmounted. Thereafter, light-touch regulation relied upon the common law courts to determine rights and obligations between supplier and purchaser—that is, the norms of market behaviour. There was

regulation.html> accessed 29 November 2016; Roman Tomasic, 'Beyond ''Light Touch'' Regulation of British Banks after the Financial Crisis', 2 March 2010 <http://dro.dur.ac.uk/8662/> accessed 29 November 2016; see also such writers as Philip Augar: <philipaugar.com>. A list of the extensive legislative activity since 2007 has been compiled by the British Bankers' Association: <https://www.bba.org.uk/wp-content/uploads/2015/05/Long_List_of_Banking_Legislation_2007-present.pdf> accessed 29 November 2016; and here <https://www.bba.org.uk/news/reports/bba-briefing-reforms-since-the-financial-crisis/#.V9fJxDs3BSV> accessed 29 November 2016; see also HM Treasury and Business Innovation and Skills 'A new approach to financial regulation: transferring consumer credit regulation to the Financial Conduct Authority' at §1.3 'The FCA will be tougher and more proactive than the FSA in tackling consumer detriment, using its judgement to intervene earlier to prevent detriment' para 1.13 <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/221913/consult_transferring_consumer_credit_regulation_to_fca.pdf> accessed 29 November 2016.

12 Under the English common law *caveat emptor* prevails. There is no general duty of good faith in commercial dealings.

13 'Right and Wrong Choices in the Market for Justice: A Comparison of Freedom of Contract under ENGLISH LAW with Civil Code Jurisdictions' *Financial Times* (21 March 2006) <http://www.ft.com/cms/s/0/04f4c5dc-b87f-11da-bfc5-0000779e2340.html#axzz4K7wcdDCf>.

14 For example, the professions: medical, legal and accounting.

15 Commonly known as information asymmetry. For information asymmetry in financial markets, see FCA Occasional Paper No 1, 'Applying Behavioural Economics to the Financial Conduct Authority', April 2013 <https://www.fca.org.uk/publication/occasional-papers/occasional-paper-1.pdf> accessed 29 November 2016, 24. For a classical work on information asymmetry and market failure, see George Arthur Akerlof, 'The Market for ''Lemons'': Quality Uncertainty and the Market Mechanism' (1970) 84(3) The Quarterly Journal of Economics 488, Brian Hillier, *The Economics of Asymmetric Information* (Macmillan Press 1997) and George Joseph Stigler, 'The Economics of Information' (1961) 69 Journal of Political Economy 213.

16 For a critique of intrusive state regulation, see Terry Arthur and Philip Booth, *Does Britain Need a Financial Regulator? Statutory Regulation, Private Regulation and Financial Markets* (Institute of Economic Affairs 2010).

17 In the case of solicitors, the Law Society and barristers their Inn of Court, although moves towards 'independent' state funded regulators have been made there.

18 FSMA2000 ss 1C(1) and 1D(1), respectively.

nothing light about the courts' touch. On a proper understanding, therefore, light touch regulation cooperated with the heavy hand and the long arm of the common law.[19]

However, the possibility of money compensation for supplier abuse through the courts—often years after the event—is often unattractive to consumers. Imagine, for example the businessman driven into bankruptcy by a mis-sold swap. For such impecunious consumers, there was often no chance of access to justice through the courts; to them, the rule of law was a chimera.[20] This vacuum of justice gave rise to political demand for something to fill it. Enter the heavy-touch conduct regulator.

What, then, does the move to heavy-touch regulation entail? In the view of this author, heavy-touch regulation has three broad characteristics.

Characteristic 1: removal of the regulatory function from suppliers

The first is the transfer of the regulatory function from the profession/guild/market 'elders' themselves to an entity, created by the state which is cast as being independent of the suppliers in the market. This transfer has broader[21] political credibility, as in the age of universal franchise the state-created regulator is perceived to be more readily motivated by consumer interests than a regulator which is populated by suppliers. The political expectation created by this first characteristic is therefore more vigorous action on behalf of consumers.

Characteristic 2: extensive use of inquisitorial powers

The second characteristic is the grant to the state-created regulator of extensive inquisitorial powers.[22] These allow the regulator to be proactive in the market; it does not sit back and let the market get on with it, instead, in the faith that the regulator is smarter than the market itself, it is empowered to poke into all corners of market activity in the hope of preventing the next crisis.[23]

Characteristic 3: imposition of obligations on suppliers by secondary legislation

The third characteristic is for Parliament—trusting the regulator rather than itself, the market or the courts—to delegate to the regulator the power to make law. Thus,

19 'Export of English Law Falters on Credit Crunch', Michael Peel, Financial Times 27 May 2009. Lord Woolf is quoted as seeing 'the credit crunch more as a failure of regulation than of the rule of law, [but] it had led to unease about the spread across the commercial world of English-style legal systems.' See also Jeffrey Golden, 'We Need a World Financial Court with Specialist Judges' *Financial Times* (9 September 2009) <https://www.ft.com/content/36609410-4a4a-11de-8e7e-00144feabdc0> accessed 29 November 2016: 'The papers are full of stories about financial market regulators and regulation, but we read little about our courts' preparedness to interpret that regulation and deal with the highly technical cases that could follow financial upheaval.'

20 See, eg the work of non-profit campaign group Bully Banks <http://www.bully-banks.co.uk> and the organization SME Alliance <http://www.smealliance.org/our-agenda.html> accessed 29 November 2016.

21 Even if this is at the expense of the regulator's credibility with suppliers or purchasers in the market.

22 For example, FSMA2000 ss 166, 166A, 167 and 168 grant the FCA the power to appoint persons to produce reports, collect information and conduct general and specific investigations. The FCA also has surveillance powers: <https://www.fca.org.uk/news/speeches/surveillance-fcas-expectations-and-toolkits> accessed 29 November 2016.

23 After being granted such inquisitorial powers, the regulator will feel the need to exercise them to the maximum extent its budgets will allow. This is because when the next crisis comes, the last thing it wants is to be accused of being asleep at the wheel. From a supplier's perspective, it looks like an incentive with lots of regulatory activity, but not necessarily for efficient or effective regulatory activity.

Parliament, by primary legislation,[24] grants to the regulator extensive powers to create regulation—that is, law by another name—by means of secondary legislation. This kind of law-making is, of course, limited to the market that the regulator regulates. Nevertheless, it comprises of two important kinds of obligation for the markets.

The first is an obligation of a public law nature, that is obligations on the supplier to the regulator as an emanation of the state—the old barriers to entry raised much higher than they once were and regularly re-formulated as the regulator uses its inquisitorial powers to understand market activity.[25]

The second kind of obligation is one for the benefit of the consumer as against the supplier. Certain types of consumers can rely on these laws or regulations to give them a private cause of action that they can enforce directly against suppliers. In the case of financial services, both species of law created by the FCA itself appear in its Handbook.[26]

The reader will observe that the more the state grants powers to the state-created regulator, the more the state-created regulator looks like the state itself. From what the author set out above, it is quite apparent that the regulator is exercising two functions of the state that are normally kept separate: the legislature (which makes the laws) and the executive (which enforces them). In Britain, we have never been purists[27] about the separation of powers. However, we have always been aware that the more you dissolve the boundaries between the three arms of the state, the more likely you are to run into trouble.

3. The boundaries of heavy-touch regulation transgressed

The reader can see where the author is going. The next logical step in the direction of travel towards heavier touch regulation is for the regulator to usurp the third arm of the state: the judiciary. In fact, the FCA had, well before creating the swaps mass redress system, grown accustomed to exercise the judicial function of interpreting the law; its Handbook contains extensive 'Evidentiary Provisions' aimed at assisting it to interpret the law it created.[28]

24 FSMA 2000: FCA's general rule making power (s 138), see Small Business, Enterprise and Employment Act 2015: FCA may take action for monitoring and enforcing compliance with the regulations (s 6(1)), FCA can impose disciplinary measures and make subordinate legislation (s 6(3)).

25 As a result, they present a constant challenge to suppliers to keep up with. This is the so-called 'ever-increasing red tape'; regulation which is often complained about as being vague, opaque or simply too voluminous for any but the largest supplier to stay up to date and comply with if the red tape does suffer from these defects, regulation tends to favour the incumbent suppliers and therefore stifle the FCA's third objective, competition.

26 The size of that Handbook and the work involved in understanding, on the one hand, which rights bind which supplier and, on the other hand, which of those rights give a direct cause of action from consumer to supplier, goes some way to making the point about 'ever-increasing red tape' heavy touch regulation generates. With every new power comes a new problem.

27 'The Separation of Powers', House of Commons Library SN/PC/06053: <www.parliament.uk/briefing-papers/sn06053.pdf> accessed 29 November 2016. 'Why We Need a Separation of Powers', Andrew Turnbull *Financial Times* (2 June 2009) <http://www.ft.com/cms/s/0/73f524ca-4faa-11de-a692-00144feabdc0.html>: 'The striking thing about the UK is not how much we have adopted this principle [separation of powers] but how little.'

28 In primary legislation passed by Parliament, guidance on interpretation is almost never given. The legislation is supposed to speak for itself and it is seen as the role of the Court to explain it where called upon to do so. It remains to be seen what the judiciary will make of these provisions. By way of analogy, in the case of W Limited and M SDN BHD [2016] 1 Lloyd's Rep. 552 the English High Court refused to follow the IBA Guidance on Conflicts in International Arbitration.

There was an apparently compelling reason for the FCA to continue its direction of travel to dispute resolution itself: the common law courts are not an effective place for David to take on Goliath in commercial disputes. So something else was needed to fill that vacuum. The regulator felt the pressure to do so. It decided to fill it, ad hoc, with what can fairly be described as executive fiats to banks, ordering them to make redress where the regulator thought it was needed.

The solution of executive fiat seems attractive in a political crisis, when the overwhelming political pressure is for Something To Be Done. The political pressure comes from the consumer, and it assumes that everyone knows what needs to be done; it is just a matter of getting on and doing it. In the consumer's view, the regulator is, of course, the person for the job. But this is just when the regulator should be on its guard; for when the regulator provides its answer to the market by executive fiat, it does so both to supplier and to consumer. If the regulator's idea of a just—or sufficiently just—outcome is something different from the consumer's, then the political pressure quickly transfers from the banks to the regulator. That is exactly what has happened here.

However much the consumer clamours for Something To Be Done, the regulator is well advised to remember that the world of executive fiat is a different world from the common law world to which the consumer is in fact accustomed. No doubt also that, used properly, executive fiat[29] will cause the consumer in due course to be grateful to its regulator. But a regulator that uses it inappropriately puts itself in harm's way. This is because on its application, two principal weaknesses become evident—particularly to a public used to common law concepts of justice, or, as Dr Bailey metaphorically puts it, one's day in court.

Transgression 1: a process that gives the impression of corporatism

If the reader will indulge me, I will myself resort to metaphor for the opposite reason that Dr Bailey deployed it. I do so for the following reason. A vacuum is created when an adjudicator forgets about the need for justice to be seen to be done.[30] When expectations of open justice are not met in that way, the public mind finds it very easy to fill the vacuum with its worst imaginings. Conspiracy theories thrive. As I do not posit fact but illustrate imaginings, metaphor is a convenient vehicle to convey those imaginings.

Imagine, for a moment, that, in 2007, I was at the helm of a too-big-to-fail bank which, for almost two decades, had been sailing close to the wind, selling—amongst other things—swaps to small businessmen who had not understood them.[31] Then, when the clouds began gather above me that year, I would have felt fear. I would have paced the

29 When redress is largely an administrative exercise, like giving redress for mis-sold PPI.

30 An expression assimilated into common discourse which finds its origin in Lord Hewart CJ's observation in *R v Sussex Justices, Ex parte McCarthy* [1924] 1 KB 256, 259: '... a long line of cases shows that it is not merely of some importance but is of fundamental importance that justice should not only be done, but should manifestly and undoubtedly be seen to be done.'

31 'Banks Set Aside £700m for Swaps Scandal', Brooke Masters and Jennifer Thompson *Financial Times* (31 January 2103) <https://www.ft.com/content/1ced9d24-6b7b-11e2-a700-00144feab49a> accessed 29 November 2016: 'The [FCA] ordered the four banks (Barclays, HSBC, Royal Bank of Scotland and Lloyds) to review all their sales of interest rate hedging products, including swaps and more complicated products, to small businesses that it concluded were ''unlikely to understand the risks associated with those products.''

deck, tapped the barometer, tested the regulatory and political atmosphere and fretted about the balance sheet that would have to keep me afloat in the coming storm.

My first command, no doubt, would have been to change tack, come alongside Her Majesty's Ship (HMS) Treasury, request permission to board, where I would have sought to persuade the politicians and the regulators that it was in no one's interests that my vessel should end up on the seabed with all hands, her creditors unpaid.[32] Indeed, I might have seen it as my duty to frighten the politicians so much by this prospect that they would board my vessel in my place, take the wheel and announce to the passengers that they had saved the ship.[33]

But, even then, I would have known that was not the end of it. As an old sea dog, I would have sensed that we had moved into a new season of hostile weather.[34] More than the public dressing down[35] by my new masters, more than their docking my wages,[36] I would fear a hurricane of litigation being whipped up by claims handlers, accelerated by a front of third-party litigation funding, which would dash me onto the rocks of the Courts until my balance sheet was smashed into little pieces. What, I wonder, could I do to avert that catastrophe?

Again, I would have sought to persuade the politicians and the regulators that this outcome would be in no one's interests. Since they now owned the ship,[37] I would have their close attention. And again, I might have considered it my duty to frighten them with the prospect of this new and hostile front which had built up in the days when they liked to tell the world they made the weather.[38] As an old hand, I would have known that I

32 Between 2007 and 2010, the government injected a total of £107.6 billion into Lloyds TSB, Royal Bank of Scotland and UKAR, the holding company that manages the assets of Bradford & Bingley and Northern Rock; 'UK Investment in Royal Bank of Scotland' Rothschild Report to HM Treasury, 10 June 2015.

33 Hansard records the following at Prime Minister's Questions on 10 December 2008:

> The Prime Minister: The first point of recapitalisation was to save banks that would otherwise have collapsed. We not only saved the world— [*Laughter.*]—saved the banks and led the way— [*Interruption.*] We not only saved the banks— [*Interruption.*]
> Mr. Speaker: Order.
> The Prime Minister: Not only did we work with other countries to save the world's banking— [*Interruption.*] Not only did we work with other countries to save the world's banking system, but not one depositor actually lost any money in Britain. . . .

<http://www.publications.parliament.uk/pa/cm200809/cmhansrd/cm081210/debtext/81210-0002.htm#08121022000009> accessed 29 November 2016.

34 See <http://news.bbc.co.uk/1/hi/business/7521250.stm>.

35 See, eg 'Goodwin's Undoing', Peter Thal Larsen *Financial Times* (25 February 2009) <http://www.ft.com/cms/s/0/3776f564-02de-11de-b58b-000077b07658.html> accessed 29 November 2016.

36 'Ex-Royal Bank of Scotland Chief to Give up a Third of His Pension', Jane Croft and Jim Pickard *Financial Times* (19 June 2009) <http://www.ft.com/cms/s/0/118eab82-5c69-11de-aea3-00144feabdc0.html>.

37 See, eg < https://www.nao.org.uk/highlights/taxpayer-support-for-uk-banks-faqs/> accessed 29 November 2016.

38 Mansion House speech on 20 June 2007 by the Chancellor Gordon Brown <http://webarchive.nationalarchives.gov.uk/+/http:/www.hm-treasury.gov.uk/2014.htm> accessed 29 November 2016:

> . . . in a study last week of the top 50 financial cities, the City of London came first. So I congratulate you Lord Mayor and the City of London on these remarkable achievements, an era that history will record as the beginning of a new golden age for the City of London. And I believe the lesson we learn from the success of the City has ramifications far beyond the City itself-that we are leading because we are first in putting to work exactly that set of qualities that is needed for global success. . . . And I believe it will be said of this age, the first decades of the 21st century, that out of the greatest restructuring of the global economy, perhaps even greater than the industrial revolution, a new world order was created.

should never approach my new masters with a problem alone; to maximize my influence, I would need a solution for them too.

So, as I straightened my tie at the door my new masters' cabin, I would have asked myself, what is the most I could persuade these politicians and regulators to do for me? Might I be able to persuade them to stop the cases against my bank from going to court? Might I get them to agree to prefer some kind of alternative dispute resolution system? Perhaps . . . but as for its terms . . . what would be just too much to ask? What would I dare to put on my wish list? Well, I might have said to myself: in for a penny, in for a pound.

Here goes. I would want a dispute resolution system that I myself was in charge of. I would want it to be secret. I would not want it to apply the law, because I would not want it to create any legal precedent about my behaviour. I would want to be allowed to deny claimants full compensation, in particular consequential losses. In fact, as their principal remedy, I would not want to pay them cash. Instead, I would want to substitute the profitable product I had sold them with another of my products, which was not quite so profitable but still turning a healthy margin. And so, with problem and solution at the ready, I would straighten my cap, tap lightly and wait until apprehensive voice within bid me enter.

Now, we do not know what was said in the privacy of the captain's quarters, but we do know the mass redress system the banks got in 2013.[39] They got one that exactly matches that wish list: a swaps mass redress system, which the banks themselves ran, which operated in secret, which did not apply the law, produced no legal precedent, which did not award consequential loss[40] and in which the principle vehicle for compensation was the opportunity to sign up to a new financial product with the same bank. It is a very long way from a common law public's idea of open justice.

The only aspect of the system that may not have been on a bank's wish list was the requirement that section 166 'skilled persons' ensured that they adhered to those rules and that the banks pay for them to do so. But as the rules were so generous to the banks anyway, and as those 'skilled persons' were the banks' best friends—the big four accounting firms[41]—it looks like it would have been an easy compromise for the banks to make. The 'skilled persons' requirement certainly did nothing to mitigate the cynicism of

39 Samuel (n 9) 4–5.

40 Jeremy Roe, of Bully Banks, having analysed the FCA's annual report, observed at the FCA's Annual Public Meeting on 19 July 2016 <https://www.fca.org.uk/publication/other/annual-public-meeting-2016-question-answer-session.pdf> accessed 29 November 2016:

> There were 16,500 instances of the mis-sale of interest rate hedging products reviewed by the banks. Over 90% of these were found to have been mis-sale. Of the individuals who were rewarded redress, of that 16,500, 3,250 have brought consequential loss claims. The mis-sale of these products resulted in major losses to small businesses. Of the consequential loss claims which have been determined, the 3,250, 97% of consequential loss decisions are less than £10,000. Those figures, that hard data, comes from the FCA.

41 'Law Firms Queue up for FSA Banks Panel', Caroline Binham *Financial Times* (September 13 2012) <http://www.ft.com/cms/s/0/6f269fc0-fdbf-11e1-8fc3-00144feabdc0.html> accessed 29 November 2016: 'Data show that the Big Four undertook half of the 88 reports in 2009-2010. . .'; 'External experts help FSA probe banks', Paul J Davies *Financial Times* (3 January 2010) <http://www.ft.com/cms/s/0/7143727c-f897-11de-beb8-00144feab49a.html>: 'The City watchdog is using external experts to conduct

the public.[42] If fact, certain members of the public might be forgiven for thinking that the banks—who are clearly very skilled at handling the regulator—might have included it on their wish list as sop.

Now, there is a word for these imaginings: corporatism[43]—the capture of the regulator by the industry it is supposed to be regulating. Who persuaded the politicians and the regulators to adopt light touch regulation before 2008 and who profited from that regime? Who persuaded the politicians and regulators in 2008 to nationalize their losses when light touch went wrong? Who persuaded the politicians and regulators in 2013 to set up a redress system that was absurdly generous to the banks? None of these impressions need to be proven as fact for them to damage confidence in the regulator. They just need to be sufficiently plausible to lodge in the public mind.

Transgression 2: a product that does not clarify the law for the market

It is common place for legislators (or regulators) to express concern about the cost of common law justice.[44] It is quite true that the common law courts and arbitrations can be prohibitively expensive. As a result, alternative dispute resolution systems are promoted by legislators and regulators[45]—and rightly so. In the case of the FCA, it has the Financial Ombudsman Service (FOS)—its main Alternative Dispute Resolution (ADR) arm arm, close to but independent of the FCA,[46] and independent of but funded by the banks.[47] It does great work helping settle cases. The FCA based its swaps mass redress system on similar ADR methodologies as those employed by the FOS.

Now, there is no doubt that ADR is a good way for a regulator to pursue its policy objectives by delivering inexpensive access to compensation for unhappy consumers. However, the ADR product is only that: a settlement for the parties. ADR does not produce what a court produces: clarification of the law for the benefit of the market as a whole. In fact, it does not even apply the law, but does what seems to it to be reasonable.[48]

supervisory reviews into the actions of some of the UK's struggling banks, including Royal Bank of Scotland and HBOS. However, people with knowledge of the probes said it was unlikely that the reports would be made public. . . .'

42 'Use of FCA-Mandated_Internal Investigations Called into Question', Caroline Binham *Financial Times* (15 March 2015). <https://www.ft.com/content/1c12e006-c9ae-11e4-a2d9-00144feab7de> accessed 29 November 2016; on 17 March 2015, Reynolds Porter Chamberlain stated that only 2 per cent of FCA-ordered reviews into financial services firms led to any enforcement action in the year to September 2014 <https://www.moneymarketing.co.uk/rpc-just-2-of-fca-s166-reviews-led-to-enforcement-in-201314/> accessed 29 November 2016; Allen and Overy reported on 3 August 2013 that data from the FCA shows that very few Skilled Person Reviews commissioned by the FCA since 2013 have actually led to any enforcement activity: <http://www.aoinvestigationsinsight.com/fca-skilled-person-reviews-not-necessarily-a-precursor-to-enforcement-action/> accessed 29 November 2016.

43 'The control of the state or an organisation by large interest groups' Oxford English Dictionary.

44 See, eg 'Review of Civil Litigation Costs: Final Report' Jackson LJ, December 2009 <https://www.judiciary.gov.uk/wp-content/uploads/JCO/Documents/Reports/jackson-final-report-140110.pdf> accessed 29 November 2016.

45 And it is now built into our courts system: see, eg CPR r1.4(1)

46 The relationship between the FCA and the FOS is described in a memorandum of understanding dated 18 December 2015: <https://www.fca.org.uk/publication/mou/mou-fos.pdf> accessed 29 November 2016.

47 Banks pay an annual levy that varies in size: <http://www.financial-ombudsman.org.uk/faq/answers/research_a5.html> accessed 29 November 2016.

48 DISP 3.6.1R: The Ombudsman will determine a complaint by reference to what is, in his opinion, fair and reasonable in all the circumstances of the case.

Over-reliance on the ADR process and product, therefore, partially[49] achieves one of the FCA's operational objectives—consumer protection—at the expense of its other two operational objectives: integrity and competition.[50] Only clear and predictable law can achieve all three. Over-reliance on ADR means that the disputes are settled, but the issues in the dispute are swept into a sort of legal black hole and the opportunity to clarify the law in the wider public interest is lost.[51]

In order to fulfil the three statutory operational objectives, the FCA should be finding a way to put its market disputes into the common law system. That system applies the law to the facts of the case with the result that legal duties are clarified and defined and the dispute disposed of. That is one of four essential characteristics of the common law system that the FCA cannot afford to do without.

4. The common law system, friend to the regulator: four characteristics

Light touch regulation may have been open to the charge of corporatism for the reason that it was akin to self-regulation, so the public is inclined to believe that in the last analysis suppliers in a market will regulate in their own interests. However, as light touch powers were limited, it probably did not matter much; only when a market crisis emerged did the impression of such corporatism create wider political concern.[52] As light touch regulation left dispute resolution to the common law system, day-to-day disputes were resolved with the benefit of the public trust the common law system enjoys. As trust is the holy grail of Dr Bailey's deliberations, this author suggests consideration of four key characteristics of the common law system on which public trust in it is based.

DISP3.6.4R In considering what is fair and reasonable in all the circumstances of the case, the Ombudsman will take into account:
(1) relevant:
  (a) law and regulations;
  (b) regulators' rules, guidance and standards;
  (c) codes of practice; and
(2) (where appropriate) what he considers to have been good industry practice at the relevant time.

Also, each published determination by FOS contains the following statement: 'I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.'

49 Because ADR normally under-compensates the claimant and goes no way to clarifying the effect of the rights the claimant enjoys.

50 The FCA's three operational objectives are found at s.1C-E FSMA 2000.

51 In the case of swaps sold to small and medium sized enterprises (SMEs), the expectation is that the courts would determine the extent to which the equity will intrude on the relationship between banker and retail client or its principles would inform application of the Handbook rights. The courts have not had the opportunity to explore these issues because the cases were funnelled away from them and into the mass redress system. By way of analogy, the Lord Chief Justice recently expressed concern about tight restrictions on the right of appeal from arbitrations having this unintended negative consequence on the public interest: Bailii Lecture 9 March 2016.

52 For example, self-regulation at the Lloyds insurance market came under sustained criticism during its crisis in the early 1990s: see Andrew Duguid, 'Lloyds' of London: A Market in Crisis' June 2015 <http://onthebrink.uk.com/wp-content/uploads/Casestudymark7.1.pdf> accessed 29 November 2016. For further reading determine: Andrew Duguid, *On the Brink* (Palgrave Macmillan 2014).

Characteristic 1: the common law courts are truly independent

First, its principal forum—the common law court system—is truly independent.[53] This is because the courts are passive; they wait until the parties bring cases to it to decide. In this regard, it stands in contrast to a regulator, which has a duty to be active. In particular—unlike the courts—the regulator sets the regulatory framework within which the market operates—be it light or heavy touch or something in between—and investigates to ensure good conduct. These two roles are meant to prevent the crisis or mis-selling—that is, the very things which have given rise to the dispute to be adjudicated on. The regulator cannot, therefore, be independent in the true sense of the word; it is by definition a participant in the dispute.

Characteristic 2: the common law's adversarial system generates trust

Secondly, the common law operates the adversarial system: that is each party gets its opportunity to have its say and to test thoroughly the story of the other side. It is presided over by judges who have spent their careers as self-employed practitioners at the independent Bar[54] who do not drive forward the parties' contentions, but who are, like referees, thoroughly versed in ensuring that the process by which the parties drive forward their contentions is fair and is seen to be fair. As a result, the common law court system is one of the few institutions which has broadly maintained the public trust that other institutions have lost over the last 30 years. The authority they enjoy means that—more often than not, and in contrast to the FCA's experience of dispute resolution—sore losers complaining about the system that delivered judgment are not seen as soothsayers but fools.

Characteristic 3: the common law operates a system of open justice

There is a third characteristic of the common law system that is important to the trust that the public repose in it.[55] That it is a system of 'open justice'—which depends on reasoned argument and reasoned decisions—which develops from year to year, as one judge after the next adds to the sum of knowledge. I hope the reader is not embarrassed by my comparing it to open-source software: a product that constantly evolves, which is generated by a process to which any can add and which refines itself by peer-review. The most celebrated example of this 'open-source' process of law creation is the development in the twentieth century of the law of negligence–from established categories into legal principles of general application–by judges throughout the Commonwealth deciding the just outcomes to

53 A brief history of the development of the independence of the judiciary can be found here: <https://www.judiciary.gov.uk/about-the-judiciary/history-of-the-judiciary/> accessed 29 November 2016.

54 Albeit, non-barristers are now actively recruited to fill judicial positions: see, eg. <https://www.judiciary.gov.uk/about-the-judiciary/who-are-the-judiciary/diversity/judicial-diversity-statistics-2016/> accessed 29 November 2016.

55 Public opinion and the jury <http://www.icpr.org.uk/media/10381/Juries%20MOJ%20report.pdf> accessed 29 November 2016: an international literature review, Ministry of Justice Report February 2009 'The right to trial by jury in this context was rated as more important than any of the other rights, including the right to protest against the government, the right not to be detained for longer than a week before being charged, the right to privacy, the right not to be exposed to offensive views in public, and the right to free speech in public.'

cases.[56] The product of that process—the 'duty of care'—is one of the few phrases with which almost any layperson is familiar; such is the power of 'open-source' legal reasoning.

By issuing public judgments on the facts and arguments of those cases, the courts work out the principles that underlie the norms of market behaviour: i.e. the law.[57] Laborious as that task is, it is not wasted effort. Being an open and reasoned development of the law, the market is able to watch the cases closely, assimilate the principles and practices that the court smiles upon—the norms of market behaviour it favours—and the market adjusts its behaviour accordingly. In non-legal terms, the common law operates as a sort of 'feedback-loop' for market participants.

An example from the past of a regulator using the common law courts as its friend—happy to do the difficult work of resolving disputes and working out norms of market behaviour—comes from a financial crisis a quarter of a century ago: the Lloyds crisis. That crisis provided one of the set-piece dramas of the development of the law of negligence in the common law courts. The light-touch regulator of Lloyds stood back and let names[58] bring private actions against the managing agents for mismanaging their risk. Within 8 years,[59] the courts had worked out—by means of 'open-source' reasoning, drawing on the arguments of the parties in the lead cases—the principle that the agents owed names a duty of care even where there was no contractual relationship between them. In response to that clarification of the law, the market—with regulatory assistance—was able to organize itself by re-insuring the

56 See, eg *Clerk & Lindsell on Torts (Common Law Library)* (21st edn) 8.05–8.28. 2016 Sweet & Maxwell, ed. Michael A. Jones, Anthony M Dugdale, Mark Simpson

57 Lord Simon of Glaisdale, in *Knuller (Publishing, Printing and Promotions) Limited & Others v Director of Public Prosecutions* [1973] AC 435, put it this way at page 492:

> . . . the common law proceeds generally by distilling from a particular case the legal principle on which it is decided, and that legal principle is then generally applied to the circumstances of other cases to which the principle is relevant as they arise before the courts. As Parke B. said, giving the advice of the judges to your Lordships' House on *Mirehouse v Rennell* (1833) 1 Cl. & F. 527, 546 (cited with approval in *Shaw* [*supra*] by Lord Tucker (p.289), Viscount Simonds (p.261) and Lord Morris of Borth-y-Guest (p.291) concurring, and by Lord Hodson (pp.292-293):
> 'Our common law system consists in the applying to new combinations of circumstances those rules of law which we derive from legal principles and judicial precedents; and for the sake of attaining uniformity, consistency and certainty, we must apply those rules, where they are not plainly unreasonable or inconvenient, to all cases which arise; and we are not at liberty to reject them, and to abandon all analogy to them, in those to which they have not yet been judicially applied, because we think that the rules are not as convenient and reasonable as we ourselves could have devised'.

58 Lloyds of London is an insurance market founded in 1688 by Edward Lloyd. It is a mutualized market place where multiple financial backers and finance providers are grouped together in syndicates to pool and diversify the risk. The financial backers and financial providers are either limited corporations or Names (private, almost always rich, individuals with unlimited liability): see <https://www.lloyds.com/the-market/operating-at-lloyds/market-services/useful-information/membership-overview> accessed 29 November 2016.

59 By contrast, today, in 2016, we are now eight years on from the financial crisis, and this author does not know a lawyer who can tell you with confidence what the legal duties imposed on a bank by the FCA's Handbook actually mean when they sell a swap to an SME. Why is that? It is because almost all disputes between SMEs and banks were scooped up out of the common law system into the legal black hole that was the FCA's bespoke swaps dispute resolution system. However much compensation the FCA likes to brag that its system delivered for consumers—and however the figures it brags about are calculated—the absence of legal clarity eight years later represents a clear failure by the FCA to achieve its consumer protection and integrity objectives.

agents' liabilities through the creation of Equitas. The feedback loop closed; the market survived. It now thrives.[60]

Characteristic 4: the common law system creates law on demand

A fourth characteristic of the common law system, less well remarked upon, is that the process of making law is demand-led. That is to say, when a divergence of opinion arose in the market as to the proper norms of behaviour, the market participants concerned approached the courts for the judges to decide. The law was created in direct response to demand in the market place. It was not imposed 'top down' by the state or regulator onto the market irrespective of demand.

Occasionally, of course, Parliament took it upon itself to pass primary legislation by way of statute, the markets continued to rely on assistance of the adversarial, common law system to understand the intention of Parliament as revealed by the statute. The case law that the courts produced clarified the legislation for the benefit of the market. In this respect too, the adversarial common law system creates a 'feedback-loop' for the market.

In summary, it can be said that the common law system trusts the market to establish its norms of behaviour through the agency of the courts. The market trusts the common law in return.

Now, we know that the adversarial common law courts are very good at what they do; over the centuries the courts have created a body of case law, which means that the English common law is one of the most rational and predictable in existence.[61] The output of these courts, decade after decade, has made the English common law the pre-eminent choice for commercial parties transacting all over the world.[62] It therefore makes overwhelming sense for an Anglo-Saxon regulator to make a friend and collaborator of the common law system. A regulator should not seek to usurp it and displace its methodologies.

5. The common law system adapted to new policy needs: a historic regulatory example

An example of a department of state befriending the common law system to help it achieve its policy objectives is provided by what is now the Department for Business,

60 'Names Return to Lloyd's in Downturn', Ellen Kelleher *Financial Times* (12 January 2009) <https://www.ft.com/content/75d2731a-e0e7-11dd-b0e8-000077b07658> accessed 29 November 2016. See also Financial Results of Lloyd's <https://www.lloyds.com/lloyds/investor-relations/financial-performance/financial-results> accessed 29 November 2016.

61 *Golden Straight Corporation v Nippon YKK (The 'Golden Victory')* [2007] 2 AC 353, 368D para 1 (Lord Bingham): 'the quality of certainty [is] a traditional strength and major selling point of English commercial law.'

62 In November 2008, Allen and Overy reported that English common law was the most widespread legal system in the world, as 30 per cent of the world's population and 27 per cent of the world's jurisdictions operated an English common law system: <https://www.sweetandmaxwell.co.uk/about-us/press-releases/061108.pdf> accessed 29 November 2016. A survey in January 2016 by the Singapore Academy of Law of 500 lawyers working in the region on cross-border transactions, reported that English Law was the most popular choice of governing law with 48 per cent of market share, Singapore law was second with 25 per cent of market share: <http://www.sal.org.sg/Documents/SAL_Singapore_Law_Survey.pdf> accessed 29 November 2016 3. In the Law Society's publication, 'England and Wales: the Jurisdiction of Choice: Dispute Resolution' reports that 80 per cent of cases in the Commercial Court, involve a foreign claimant or defendant: <http://www.eversheds.com/documents/LawSocietyEnglandAndWalesJurisdictionOfChoice.pdf> accessed 29 November 2016.

Energy and Industrial Strategy[63] (BEIS) when it was charged with bringing about the employment law revolution of the 1960s.[64]

At that time, a policy decision was taken that workers needed more protection than the common law afforded them because industrial action was being used as a means of resolving individual employment disputes. Parliament passed primary legislation to protect workers from unfair dismissal, as it would later protect people against various forms of discrimination. The legislation simply said that workers shall have the right not to be unfairly dismissed, or discriminated against. It was as simple as that.

Neither BEIS nor the Equal Opportunities Commission themselves sought to resolve individual disputes between employer and employee. Nor did they issue executive fiats requiring employers to sit in judgment over their own unfair dismissals or sexual harassment. Does anyone for one second think society's attitudes to workplace behaviour—in particular women and ethic minorities—would have changed as they have since then if that was how those policy objectives were pursued?

Instead, they trusted the common law system. That means they trusted employees themselves to drive forward the law on fairness and discrimination by pursuing cases that affected their lives. But it would be wrong to say they trusted the common law courts. They did not. They could see that however fair the common law courts are, there is a barrier to entry that keeps most employees from their doors; in particular the rule that the loser pays the winner's costs. They could also see that unfair dismissal was a political issue—just like discrimination would be later—and the authority of the Tribunals and the confidence of the citizen in its rulings would require a broader base of social and workplace experience than existed on the common law bench.

They therefore took the best of the common law by taking what are now Employment Judges, teaming them with representatives of the unions and business, and created what are now Employment Tribunals where this mix of lawyers, workers and businessmen could work out how the principles, of law should be applied to the facts of the cases before them. It lowered the barrier to entry by removing almost all costs risk and introducing an inquisitorial power to compliment its basic adversarial architecture.[65]

When the Tribunals first sat down to their work in the 1960s, discrimination was the norm and the law still spoke of 'master and servant'.[66] In large part, through the public hearings before and the publicly-available case law created by those tribunals, just look how far our society has moved on: discrimination can now fairly be spoken of as nothing less than a secular sin; no one speaks of masters and servants. By any standard, that is a remarkable policy success for a department of state.

63 The successor in July 2016 to the Department of Business Innovation and Skills (BIS), which was the successor in June 2009 to the Department of Business Enterprise and Regulatory Reform (BERR), which in June 2007 succeeded the Department of Trade and Industry (DTI), which in October 1970 succeeded the Board of Trade, which dated back to 1621: <http://webarchive.nationalarchives.gov.uk/20090609003228/http://www.berr.gov.uk/aboutus/corporate/history/outlines/BT-1621-1970/page13919.html> accessed 29 November 2016.

64 For a fuller discussion, see Samuel (n 9) 8–12.

65 For a fuller analysis, ibid 10–12.

66 ibid 138.

6. The common law system adapted to new policy needs: a modern regulatory example

At exactly the same time that the FCA issued its executive fiat to banks to compensate customers for mis-sold swaps,[67] BEIS decided how it would pursue its policy of ensuring that SMEs and consumers, who 'currently have very little practical opportunity to obtain redress'[68] for anti-competitive behaviour have proper access to justice. In January 2013 BEIS's 'Private Actions in Competition Law: A Consultation on Options for Reform' concluded with a 'Final Impact Assessment'[69] and the 'Government Response'.[70] Those two reports would make instructive reading for Dr Bailey's team at the FCA today.

All the more so, since on 1 April 2013 the FCA was given a third statutory objective:[71] to promote competition in financial services. Much of the reasoning of the BEIS's reports is now directly relevant to the FCA. The reports contain a compelling analysis of the problems with which the FCA is still grappling, and therefore merits summary here.

The problem those reports were addressing was that the means of redress available to SMEs and consumers complaining of anti-competitive conduct were only two: the common law courts and, in limited circumstances,[72] in the Competition Appeal Tribunal (CAT). In short, both these avenues were too expensive to be useful to consumers and SMEs.[73] BEIS therefore needed to look at other means of ensuring access to justice for those two groups.[74]

That BEIS considered this problem worthy of a solution is revealed by the way it framed its purpose in finding that solution:[75]

- 'Increase growth',[76] by empowering small businesses to tackle anti-competitive behaviour that is stifling their behaviour

67 In January 2013.

68 'Private Actions in Competition Law: A Consultation on Options for Reform-The Government Response' 9, para 22, line 9 <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/70185/13-501-private-actions-in-competition-law-a-consultation-on-options-for-reform-government-response1.pdf> accessed 29 November 2016.

69 'Private Actions in Competition Law: A Consultation on Options for Reform-Final Impact Assessment' <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/70185/13-501-private-actions-in-competition-law-a-consultation-on-options-for-reform-government-response1.pdf> accessed 29 November 2016.

70 'Private Actions in Competition Law: A Consultation on Options for Reform-The Government Response' <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/69124/13-502-private-actions-in-competition-law-a-consultation-on-options-for-reform-final-impact.pdf> accessed 29 November 2016.

71 FSMA2000 s 1E(1), inserted by Financial Services Act 2012, which came into force on 1 April 2013.

72 In 'follow on' actions after a regulator has declared default: see, eg Final Impact Assessment (n 70) 7, paras 12–14.

73 ibid 15, para 66: '[The problem for both] in terms of court processes is the prohibitive cost of even the best-run cases for smaller claims . . . legal sources estimate that private cases are prohibitively expensive unless they involve redress of at least £500k. This means that fairly substantial individual cases where redress or behaviour change is needed may not be practical to pursue through the courts.'

74 ibid 14, paras 55–56 : 'Helping small businesses is a key aim of these proposals. . . . Increasing protection for consumers is further key part of these proposals. . . .'

75 Government Response 3.

76 ibid 14, para 3.11, BEIS's rationale was as follows:

> The costs of anti-competitive behaviour in terms of lower output and higher prices of goods and services, and reduced choice and innovation, are not confined to transfers between infringer and the harmed party but include costs to society as a whole arising from productive inefficiency. These wider costs are one reason why competition law deserves specific measures designed to improve access to redress and prevent social costs arising.

- 'Promote fairness', by enabling consumers and businesses who have suffered loss due to anti-competitive behaviour to obtain redress'

BEIS had various options to achieve those aims. To understand how to choose between them, the consultation took pains to look into the policy considerations that underlay them.

Policy 1: a regulator should limit itself to regulation and supervision

The problem BEIS was addressing was, of course, very similar in nature to the FCA's problem of consumers and SMEs with claims against banks for mis-sold swaps. For them, the common law courts were also too expensive to permit effective redress. As we know, the FCA decided not to expand the FOS's jurisdiction/capacity to accommodate them. Instead, the FCA chose the route of executive fiat; it pressed into service two powers available to it to create an ad hoc system: by the threat of section 404 FSMA2000 to order the banks to make redress and by section 166 FSMA2000 to require them to have skilled persons oversee them doing so.

BEIS specifically considered adopting the FCA's two ADR processes:[77] a section 404-like power to impose redress by executive fiat[78] and a state-run ombudsman, like the FOS.[79] But BEIS turned away from both the FCA's ADR solutions. It seems it did so because, although it understood the benefits of ADR[80] it also understood its dangers, which it listed as follows:

a. creating additional arbitrary burdens on claimants and defendants
b. providing opportunities for lawyers to increase the costs of a case through lengthy but ineffective pre-trial processes
c. allowing the party with better access to information and legal provision (usually but not always the defendant) to exert pressure on the other party to accept a settlement that does not benefit them

These considerations apply equally to banking misconduct: banks' abuse of the imbalance of information, knowledge and resources at the point of sale allow it to sell inappropriate services or extract an inappropriately high price in exchange for appropriate services. At the point of dispute that same imbalance allows it to pay an inappropriately low or no price to its customer for loss caused by its misconduct. Those costs infect the whole UK economy, reducing efficiency, productivity and output of the whole. The social costs are at their most intense in the SMEs which collapse under the cost of banks' services, but those costs ripple out to society as a whole and depress output.

77 Moreover, unlike the FCA, BIS did not delude themselves about the nature of the s 404 power of dictat, Final Impact Assessment (n 70) 25, para 119: 'This would not be a judicial process. . . .'

78 ibid 24, para 115: 'The OFT / CMA could be given the power to certify a redress scheme proposed by a business that has infringed competition law to make suitable compensation to injured parties. This could be modelled on the Financial Conduct Authority's s 404 powers as they apply to individual businesses rather than whole sectors. . . . To ensure the decision was regarded as reliable by all parties concerned, it might be preferable for an independent body to make the calculations on behalf of the business. . . .'

79 ibid 24, para 116: 'Another option for ADR through the public authorities would be to give the OFT, or a new body, powers to make binding arbitration on cases. This could be modelled on the Financial Ombudsman Service (FOS), which makes rulings between consumers and financial service providers. . . .'

80 Which it enumerated as follows:

a. restoring positive working relationships between the parties
b. allowing the underlying problem to be resolved more swiftly
c. defending both parties from the uncertainties and additional costs of trial
d. reducing court costs *to the state*. (ie the judicial body, emphasis added)

d. creating a system that is so tilted towards ADR that the threat of a case ever actually reaching court is diminished, removing the pressure to settle reasonable cases

Perhaps BEIS had those insights[81] because it had spent the last 50 years 'sponsoring'[82] the Employment Tribunals. Be that as it may, the principal driver in BEIS's decision to adopt a common law-based dispute resolution system was a policy decision about the natural limits of the role of a regulator and the dangers along the path of executive fiat of mission creep and regulatory overreach:

> The Government considers that the primary duty of the OFT will be to enforce the competition regime and undertake studies and investigations in the competition regime. Any work therefore that the OFT will undertake on redress schemes would be in addition to this primary competition work, and should be a substantial burden on resource.
>
> The Government is therefore concerned that if the OFT was given a power to require a business to create a redress scheme, then this would be too great a burden for the OFT. Due to the reluctance of the company, the OFT would automatically become involved in the intricate detail of a scheme. The imposition of a scheme would very likely be contested, which could involve the OFT in lengthy appeals. Allowing redress schemes to be imposed would also run counter to the wider Government objective for ADR to be a voluntary process.
>
> The Government will therefore give the OFT the discretionary power to certify a voluntary redress scheme, but not to impose one.[83]

The history[84] of the FCA's swaps mass dispute scheme makes BEIS's apprehension look prescient.

Policy 2: enable SMEs and consumers to assist the regulator by private action

Policy 1 was a negative consideration: beware mission creep and overreach. However, BEIS also saw a positive reason to keep consumer and SME competition disputes within the common law dispute resolution system as a way of achieving its policy objectives without a commensurate burden on its resources. Again, its experience running the Employment Tribunals is likely to have helped it identify this reason.

BEIS recognized that its role as regulator was to deploy its resources on the big, high-impact cases,[85] which regrettably left SMEs without effective redress, because the regulator cannot do everything. Nor was BEIS about to re-allocate its resources away from large cases to small ones. This led BEIS to set is policy for SMEs as follows:

81 Insights (c) and (d) are particularly apposite for the FCA to consider.

82 BEIS is the 'sponsor' department of state for Employment Tribunals, in that it has responsibility for the relevant legislative framework and procedural rules. (Most other jurisdictions have the Ministry of Justice (MoJ) as its 'sponsor' department of state.) However, the funding of the Employment Tribunals and Appeals Tribunals' is the responsibility of the MoJ (and so the Lord Chancellor). Their administration is the responsibility of Her Majesty's Courts Service, which is responsible to the MoJ.

83 Government Repsonse 53, paras 6.35–6.38.

84 The first instance judicial review of the FCA's swaps mass redress system in Holmcroft Properties is currently waiting to be heard on appeal.

85 Final Impact Assessment (n 70) 6, para 3: 'The competition authorities prioritise cases to bring based on a set of criteria, and a limited budget means that they may not be able to pursue all cases. As their emphasis is on high-impact cases, their resources tend to be directed primarily at larger cases, and it is unlikely for smaller businesses in particular to receive swift resolution if they become victims of anti-competitive behaviour. . . .'

> In this case, the primary need from government is to create a framework whereby individuals and businesses can represent their own interests, rather than rely on state enforcement in competition law . . . because private actions uphold the rights of individuals to seek resolution and redress and because victims of anti-competitive behaviour are particularly well-placed to confront and address this.[86]

BEIS's policy was based on the insight that, 'an effective private actions regime would help complement the public enforcement regime.'[87] Indeed, it considered that an effective private enforcement regime working alongside the public enforcement regime would create far greater pressure for behavioural—or cultural—change in the markets. For example, it observed:

> An OFT report notes that survey evidence also shows that high profile OFT enforcement cases result in much greater behavioural change than lesser known cases . . .. The same study also gives the results of an OFT behavioural experiment that not only shows that the size of fine changed people's behaviour, but that the greatest deterrence was from an unknown fine. The unpredictable nature of private actions and the wide range of their potential results could therefore be a very powerful disincentive for infringement.[88]

BEIS had direct experience of this phenomenon in its work with the Employment Tribunals. It takes quite a lot to change workplace culture from Mad Men to one where physical contact is career-ending. What caused that change? It is conversations the manager had in the pub or reports he read in the paper about a manager just like him being cross-examined in public about his transgressive behaviour, its effect on the intern and the possibility that he will never work again. BEIS transferred the logic to anti-competitive conduct: if it could create a platform that would allow SMEs and consumers to bring claims, it could achieve a similarly powerful disincentive for anticompetitive behaviour in the markets.

With policy set, therefore, the question for BEIS was then how to execute the policy: what was the right platform to permit consumers and SMEs to do the regulator's work for them—of making behaviour or culture change happen?

7. BEIS's preferred means of policy execution

With its 50-year experience of sponsoring the Employment Tribunals Service, BEIS could dispose of the idea of smaller competition claims being heard in the county courts in two sentences:

> . . . most stakeholders consulted, including almost all legal experts, have indicated that the county courts do not have sufficient competition expertise. This would mean that such cases would not be satisfactorily resolved, and would always be vulnerable to appeals to a higher court.[89]

On the other hand, the Chancery Division of the High Court already had jurisdiction to hear competition claims, so the Final Impact Assessment focussed directly on whether to

86 ibid 11, para 30.

87 ibid 8, para 16.

88 ibid 10, para 27: 'Specifically, the replica football kit cartel led to more cases of behavioural change than any other intervention covered in the survey.' Given that the replica football case is the single example of a collective [private] action, this might reflect the increased publicity due to private collective actions.'

89 ibid 16, para 68.

introduce a fast track for small claims in that jurisdiction[90] or in the CAT[91] (which is both 'sponsored'[92] by BEIS itself and run[93] by the Competition Service).

The way forward could not have been revealed more clearly by responses to the consultation. Of all the consultees referred to in the Government Response, the only body that actually denied the need for a fast track was the Chancery Division of the High Court itself.[94] It is perhaps not a surprise, therefore, that BEIS decided that, having settled on the policy, it would be a mistake to cede policy execution to a different department of state. Indeed, BEIS observed:

> The practical detail of court rules, processes and jurisdictions can be very important for ensuring suitable cases are brought and unnecessary costs avoided. . .. In most cases these matters must be decided across the justice system as a whole, but in this policy area the existence of a specialised court, the Competition Appeal Tribunal (CAT), makes matters more flexible.[95]

BEIS therefore decided to keep control of policy execution[96] and so expanded the power of the CAT–over which it has more influence–to include a fast track for SMEs. They set themselves up to repeat their success with the Employment Tribunals.

8. FCA: one policy and three means of policy execution

So which policies and which options for policy-execution stand before Dr Bailey as he thinks about this issue? This author sees one right policy and three means of executing it.

The Policy

The right policy could be summarized as 'less is more': trying to micro-regulate or over-legislate is a mistake. BEIS satisfies itself with broad expressions of principle—be it equal treatment, fairness in dismissal or competition in markets. Likewise, the FCA should—as it largely has done—restrict itself to expressions of principle[97] and then rely on the common law system to work out how those principles should be applied in practice.

90 Which is run by the Ministry of Justice (MoJ) and Her Majesty's Courts Service (HMCTS).

91 ibid 17–21, paras 73–94.

92 BEIS 'sponsors' the CAT in that it is responsible for its legislative framework and its procedural rules.

93 Unlike the Employment Tribunals (n 82), which the MoJ funds and Her Majesty's Courts Service administers, the CAT is administered through the Competition Service, which BEIS funds.

94 Government Response 20, para 4.15.

95 Final Impact Assessment (n 70) 15, para 58.

96 It is perhaps just as well. If BEIS could not persuade the Chancery Division of the need for a fast track for smaller competition cases, then it would be an understatement to say it would have been going against the grain of the Ministry of Justice (MoJ)/HM Courts & Tribunals Service's (HMCTS) thinking to persuade it to support what BEIS actually decided to introduce in the CAT in pursuit of its policy objectives: 'opt-out' class actions, modelled on the US system, but with safeguards to prevent vexatious claims. The CBI, the nearest thing BEIS has to an industry lobby group to capture it in a corporatist strangle-hold, responded: 'The Government has let the litigation genie out of the bottle by adopting US-style collective actions.' ('Competition Lawsuits Worry CBI', Brian Groom *Financial Times* (29 January 2013).) That is one way of looking at it. As the BIS's thoroughly-thought through consultation paper demonstrated, it is only the genie of effective private actions adjudicated upon by a respected judicial body that will have the power to change market culture. That genie worked its magic on employers through Employment Tribunals, will inhibit anti-competitive behaviour through the CAT, and, if Dr Bailey can design the right platform for the FCA, should change banking culture.

97 For example, the private law duty in its Handbook at COBS 2.1.1(1) 'A firm must act honestly, fairly and professionally in accordance with the best interests of its client. . . .'

The FCA needs to do what BEIS has already done twice: build the right platform, cost effective common law dispute resolution to allow market participants to bring private actions to enforce the rights the FCA has granted them. The case law that this platform will create will, in time, establish how its principles translate into market practice.

Policy Execution 1: a specialist fast track in the High court

If that is the policy, what are the platforms that the FCA could be building to achieve it? This author sees three, none of which require any, or any substantial, primary legislation.

The first is that Dr Bailey could ask the MoJ and HMCTS to create a specialist fast track list in the High Court to permit large volumes of SMEs and consumers to benefit from the expertise of high court judges. Now, admittedly, the High Court may have recently started a Financial List for large or high profile wholesale financial services disputes,[98] but, like its Chancery Division in competition claims, it may be reluctant to lower the barrier to entry[99] for numerous smaller claims–particularly when it considers itself to under-resourced. The FCA can only ask.[100] But even if the answer is yes, the FCA would cede control of policy delivery and lose the flexibility that comes with keeping policy delivery 'in house'.

Policy Execution 2: a new chamber in the Tribunals—or expansion of an existing one

The second option is to create a new chamber for financial services disputes which would operate under the Courts, Tribunals and Enforcement Act 2007 (CTEA2007). One benefit of this approach is that, unlike courts, a judge chairing a tribunal makes his decision equally as one of three: he is joined by market experts from either side, in this case, by a member of the financial services industry and by a representative of small business.[101] This tends to give a tribunal enhanced credibility[102] in the market and even with the public, such as the Employment Tribunals enjoy.[103] The alternative is to expand The Upper Tribunal (Tax and Chancery Chamber); it already hears appeals from decisions of the FCA, so already possesses the market expertise that will be necessary to determine financial services disputes according to Handbook rules. A specialist chamber would also be cheaper than a High Court list.

98 Following the lead of PRIME Finance, the international arbitral institution and panel of experts established in January 2012, which, announced on 9 December 2015, is to be administered by the Permanent Court of Arbitration in The Hague.

99 Indeed, the MoJ's decision to raise court fees to up to £10,000 does not assist the FCA's policy objective.

100 The Chancery Division did agree to administer the Intellectual Property and Enterprise Court as a 'fast track' designed to allow small businesses to protect their IP, often from established competitors; it caps costs shifting at £50,000.

101 For a fuller discussion, see Samuel (n 9) 12–15.

102 The credibility of the Employment Tribunals has been diminished not by their process, but the ever-changing and ever-more complex substantive law with which politicians ask both them and business—particularly small business—to cope. It would be a mistake to shoot the messenger.

103 Since 2012, Employment Tribunals have increased powers to sit with an Employment Judge alone; the work of the Tribunals in the last 50 years has created a body of case law and industrial practice which has gained broad political acceptance. From 15 September to 24 November 2016 the Tribunals Service consulted on whether to introduce similar powers across the unified Tribunals Service <https://consult.justice.gov.uk/digital-communications/panel-composition-in-tribunals/> accessed 29 November 2016.

Policy Execution 3: a specialist arbitral tribunal and appeal tribunal

Third, the FCA could create a common law arbitral system[104] by agreement with the banks. Arbitral panels are also naturally a panel of three equal decision-makers who introduce industry expertise. Proceeding down the arbitral route would give both the FCA—and the banks—the benefit of keeping the rule-making 'in house', just as BEIS wanted to. The arbitral system's rules should apply the law and produce a public body of authority that clarifies the law. To that end it would need an appellate tier which, under the rules, would bind those under its jurisdiction. Its awards would be persuasive in the High Court. The system could, with the agreement of the MoJ and HMCTS, connect[105] to the Court of Appeal and Supreme Court.

Conclusion

On 9 November 2016, Andrew Bailey gave further evidence before the Treasury Select Committee. In response to the question 'Do you draw any general conclusions about these ad hoc redress schemes and how we can move forward on that?'[106] He replied:

> I do. The problem goes back to what I said right at the beginning, which is that, when it is outside the regulatory perimeter, these are schemes that are created by the firm. [The FCA has] levers that [it] can use on them, and [it does]. However, what I have learnt from my IRHP involvement, coming late into it, is that people feel that they have not had their day in court. Now, they do not want to have a literal day in court because that is obviously very expensive. However, what I conclude from this is that it is not satisfactory from the point of view of the FCA, because the FCA has been involved in creating a lot of bespoke processes. We discussed this on the board a number of times. Were there to be a [permanent] mechanism that could substitute for these [bespoke processes] let us loosely call it a tribunal, for the sake of argument rather like the ombudsman but for more complex cases, because corporate cases often are more complex, this would be a big step forward . . . [The FCA is currently] creating a lot of work for [itself]. However, I am very sympathetic to the people involved, so we have to do it . . . if there were to be a process that could substitute for [the FCA's bespoke processes] and to which people could go and know that they could go, I think this would be a big step forward.

Dr Bailey has clearly accepted the principle set out in January's CMLJ article[107]. Now his team must set about the work of choosing which of these forms of common law dispute resolution systems is right for retail financial markets. If Dr Bailey's team does adapt the common law to the FCA's policy needs, he can rest assured that the FCA will be doing no more than re-affirming the value of common law dispute resolution, which has guided markets through more crises than we would care to count.

104 A well-established means of particular markets to provide easy access to dispute resolution, the best known of which is the LMAA, which was established by the Baltic Exchange and which provides a forum for the resolution of shipping disputes from around the world.

105 Certainly, if the Lord Chief Justice is successful in having the appeal threshold in Arbitration Act 1996 lowered: Bailii Lecture 9 March 2016 <https://www.judiciary.gov.uk/wp-content/uploads/2016/03/lcj-speech-bailli-lecture-20160309.pdf> accessed 29 November 2016.

106 Treasury Committee Oral Evidence, HC 812 Tuesday 9 November 2016 Question 144 <http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/treasury-committee/financial-conduct-authority-november-2016/-oral/42882.pdf> accessed 16 December 2016

107 Tools for changing Banking Culture: FCA are you listening? (2016) 11(2) Capital Market Law Journal 129.

Postscript

On 15 December 2016, Members of Parliament (MPs) debated a motion that the FCA should set up a permanent Financial Services Tribunal modeled on the Employment Tribunals. The motion was carried.[108] During that debate, Calum Kerr (MP for Berwickshire, Roxburgh and Selkirk) enquired of George Kerevan (MP for East Lothian), whose motion it was:

> Will my hon. Friend join me in praising the work of Richard Samuel, who back in May, when we first looked at this idea, drew the parallel [with Employment Tribunals] that we have been discussing?

He should, in fact, have been calling for praise to be visited on the Capital Markets Law Journal[109] which provided the robust intellectual platform on which the parallel could be established so that the idea can now be turned into reality.

108 'That this House notes the statement presented to the Treasury Committee on 20 July 2016 by Dr Andrew Bailey of the Financial Conduct Authority (FCA); endorses his statement that the ad hoc creation of a compensation scheme within the FCA was not entirely successful and lacked perceived authority to treat customers with fair outcomes; believes that the recent headlines and allegations in the press against RBS will lead to pressure for a similar scheme; notes that many debates in this House over the years have focused on similar subjects with different lenders; believes that what is needed is not ad hoc compensation schemes, but a long-term, effective and timely dispute resolution mechanism for both regulated and unregulated financial contracts; and calls on the FCA, the Department for Business, Energy and Industrial Strategy and the Ministry of Justice to work with the All-Party Parliamentary Group on Fair Business Banking to create a sustainable platform for commercial financial dispute resolution.' See Hansard Volume 618 at 1.03pm onwards: <https://hansard.parliament.uk/Commons/2016-12-15/debates/6783C8F6-7370-4CD0-B607-7834A68AD2A7/CommercialFinancialDisputeResolutionPlatform#contribution-1AD916E7-87D6-4B5C-B963-2267-C7645A45> accessed 19 December 2016.

109 And in particular its far-sighted editor, professor Jeffrey Golden.