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Submitted via email to: redressmodernisationCFI@fca.org.uk

RE: Call for Input: Modernising the Redress System

BlackRock¹ is pleased to have the opportunity to respond to **Call for Input: Modernising the Redress System**. BlackRock's purpose is to help more and more people experience financial well-being. As a fiduciary to investors and a leading provider of financial technology, we help millions of people build savings that serve them throughout their lives by making investing easier and more affordable.

We recognise the impetus behind the call for input and the Financial Conduct Authority (FCA) and Financial Ombudsman Service's (FOS) desire to ask wide-ranging and fundamental questions about the redress system. We would emphasise however, that this consideration should be extended to the UK's compensation framework itself. Doing so will help to foster a more stable and predictable regulatory environment, which can in turn facilitate the international competitiveness of the UK economy in the medium to long term.

We are concerned that, because the cost of Financial Services Compensation Scheme (FSCS) is borne disproportionately by the whole industry, it is not helping to address the specific failures made by the sectors generating them, and indeed creates a moral hazard that disincentivises taking measures to avoid the failures in the first place.² Moreover, this contributes to a rising cost of doing business in the UK financial services sector undermining the competitiveness and growth objective.

While there were no levies raised for the Investment Provision class during 2023/24 (due to surpluses carried over from 2022/23), the level of compensation expected to be paid out by the FSCS continues to increase year-on-year due to an uplift in the volume and complexity of claims. This disproportionately affects firms who provide significant funding to the FSCS but have little or no link to the sectors responsible for the issues. Investment managers accounted for around 20% of the total FSCS levy in 2022/23 and are projected to pay 25% of total levies in 2025/26, despite not being the cause of claims. We believe an alternative approach based on the 'polluter pays' principle will remove the moral hazard and achieve a better and - post Financial Services and Markets Act (FSMA) 2023 - more appropriate balance between the FCA's primary and secondary objectives.

The current design of FSCS funding classes implies a collective responsibility for the cost of misconduct and firm failure between all financial services firms. This includes firms, such as asset managers, who have little or no business links, insight, or control

¹ BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.

² The FSCS's [May](#) and [November](#) 2024 outlooks for example, suggests that negligent advice to invest into self-invested personal pensions (SIPPs) is major driver of recent costs in the investment provision class.

over the sectors that appear to be responsible for the issues. We believe this presents a significant moral hazard.

We strongly agree that retail investors should be protected from the potential costs of misconduct or poor advice. However, we do not believe that ensuring funding for compensation through cross-subsidy between different sectors necessarily enhances trust and confidence in financial services. Ultimately, consumers are eligible for redress if a) a firm is or was authorised by UK regulators; b) misconduct has been identified; c) the firm is unable to meet the cost of redress due to insufficient resources or failure; and d) the consumer successfully establishes a claim, often a multi-year process. Availability of compensation at the end of this process does not de facto enhance trust and confidence: compensation is a consequence of conduct failures, and it is the fact that conduct failures have occurred that reduces consumer trust and confidence, regardless of whether compensation is paid.

With this in mind, we believe the FSCS should be viewed primarily as an insurance mechanism, available if firms cannot meet their own compensation liabilities. The responsibility for consumer protection and preventing failures more broadly should rest with business and regulators. As such, the compensation framework should adhere strictly to the ‘polluter pays’ principle and should therefore be fundamentally reformed to ensure that the costs of compensation are internalised by the sectors that generate them. This will require a comprehensive analysis of recent misconduct and failures, identifying the specific causes and business models that are at higher risk of failure.

In line with the ‘polluter pays’ principle, it is right that asset management firms cover any costs related to misconduct within the sector. However, any claims would be fundamentally different to those that have been identified as the main drivers of recent costs. We therefore recommend that for the purposes of FSCS funding, the provision of investment management services should be separated out from unrelated financial services that pose a different set of risks to consumers. We have reason to believe that recent compensation costs arising from asset management are low and will continue to be low.

We recognise that narrowing funding classes in this way could risk insufficient funding for overall compensation costs, although the FCA is taking steps to tackle root causes and bring down costs over the medium to long term. However, pooling the cost between unrelated sectors is not the correct solution: as it generates perverse incentives and moral hazard. Instead, compensation costs exceeding class limits should prompt further focus on tackling misconduct or the inability to meet the compensation costs within sectors causing the problems.

The level of regulatory capital held by firms, particularly in those sectors which have seen the highest number of firm failures, should be genuinely sufficient to protect consumers and deter “bad actors” from entering the market in the first place. Professional Indemnity Insurance (PII) should also provide sufficient coverage in the event of failure, commensurate with the risk that an individual or firm poses.

Conclusion

The Call for Input seeks to identify possible changes to the redress system to create a more stable and predictable regulatory environment which bolsters the UK’s international competitiveness. To that end, we continue to believe that it is important to go back to first principles on the rationale for the FSCS and make fundamental changes to its structure and operation. This can also help to provide a more stable and predictable regulatory environment and lower the cost of doing business in the UK

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financial services sector, achieving a more appropriate balance between the FCA's primary and secondary objectives and addressing moral hazard in the current system.

Yours faithfully,

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