Regulation in the public interest

Peter Lunt and *Sonia Livingstone* look at how new regulators can ensure that public interest is put at the heart of regulation, and what they still have to learn

How do new regulators in the UK develop and implement their consumer policies? Do they follow the examples of more established regulators, or do they do something new? And if so, are they as effective as older regulators? Taking the examples of the financial services and communications markets, both of which have had regulators established by and Act of Parliament, with a central place given to the public interest, this article looks at how successful the new regulators have been at meeting this requirement, and what they still have to learn.

There has been considerable regulatory convergence within both financial services and communications in the UK in recent years, with the establishment by Act of Parliament of unitary, sector wide regulators for each sector. In each case, the regulator's statutory objectives give a central place to the public interest (conceived in terms of the interests of consumers and citizens). In this short article, we critically examine these developments in order to assess the potential benefits of regulatory change for the interests of the general public. Specifically, we ask, how do these new regulators develop and implement their consumer policies? And how does the resulting picture of the consumer influence the regulators' supervision of firms and monitoring of the markets?

Under the Financial Services and Markets Act 2000, the Financial Services Authority (FSA) gained four statutory objectives:

- to maintain confidence in the market for financial services;
- to promote public awareness and understanding;
- to offer the consumer an appropriate degree of protection; and
- to reduce financial crime.

On the retail side of their operations this clearly makes the FSA a public-facing institution, in which it is required to be proactive in public engagement and as regard to public representatives from civil society. The FSA sets out to achieve these objectives through such means as acting in the consumer interest when regulating the conduct of business, ensuring that the market is efficient and delivers the advantages of this efficiency to the consumer, and taking a variety of public engagement initiatives. These latter include the development of a website, ensuring that information about regulation is made available to consumers, working in partnership with consumer representative bodies to register consumer concerns, working on consumer awareness and education, and carrying out consumer research to directly assess the issues concerning consumers.

Similarly, the Office of Communications (Ofcom) was charged under the Communications Act 2003 with the principal duty of carrying out two related functions: to further the interests of citizens in relation to communications matters and to further the interests of consumers in relevant markets, where appropriate by promoting competition. As with the FSA, Ofcom approaches its responsibility for meeting these objectives through a mixture of regulation of the conduct of business and managing the more intangible relations between firms, the public and civil society representatives of the public. It too seeks to be public-facing, with an ambitious programme of public meetings, stakeholder engagement, transparency and information provision via their website and other communicative tools, a substantial agenda of market research and public deliberation, and a programme of consumer education and awareness. While the importance of sustaining market confidence in financial services was given high priority by the FSA from the outset, Ofcom too is increasingly stressing the importance of market confidence in communications services as a key outcome of its public engagement activities.[1]

Despite working within very different sectors, the similarities between these two regulators are striking. Each has a statutory Consumer Panel closely connected to, but independent of, the regulator (that of Ofcom being modelled on the prior case of the FSA), with the task of keeping consumer interests high on the regulator's agenda, and of acting as a source of information about consumers and applying pressure on their behalf. Another commonality is that both regulators aim to be risk-based, principled regulators; this requires them to come to a view about what risks the market and the public face, and to set their priorities accordingly. In addition, both regulators, in response to the centrality of the public interest in their statutory objectives, have put considerable efforts into framing and developing their consumer policy, conducting substantial amounts of research to determine the issues that arise for consumers in these markets. In consequence, both regulators are building up considerable expertise, knowledge and understanding of consumers in their relevant fields.

In this paper, we present a critical exposition of the public-facing policies of the two regulators, focusing on their articulation of regulatory consumer policy, the research they conduct into consumer experiences, and the ways in which these activities are linked to regulatory practice. Clearly, since representing the public interest is at the core of the statutory objectives of both regulators, then their approach to interpreting, defining and researching the public interest will have consequences for the ways in which they set regulatory policy. One difficulty in evaluating the regulators' contribution to the public interest arises from the very breadth of their activities, some of which (for example, product disclosure regimes in financial services) are aimed at improving the provision of information for consumers, even though they are targeted at the conduct of business of firms. Other interventions or advice to firms is based on research evidence regarding the consumer experience; in such cases the regulator operates as a repository of expertise on consumer behaviour, which it uses to influence regulatory intervention and to inform commerce. However, in such cases, the contribution to the public interest may remain intangible, if it exists at all.

In relation to citizen interests, the relationship between commercial and public issues is even more difficult to pin down. How can the citizen interest in financial services and communications be articulated, and how should this translate into regulation? Here the regulator acts more like an institution of civil society than an economic regulator, and the consequences may be harder to measure, especially in the short term. Contemporary regulatory practice, therefore, includes policy tools that include both direct interventions and also indirect attempts to shape the market partly by engaging the public in various ways. In this respect, the 'new' regulators differ from the legacy regulators by being less focused on supervising the conduct of firms and more oriented towards reducing direct supervision. The reduction of direct supervision is brought about by combining market risk analysis and consumer research, with steps designed to improve the relationship between firms and consumers, by enhancing public understanding of financial/communications systems and their associated risks. This is partly because reform has been motivated by the attempt to reduce the regulatory burden on firms, partly in order to increase corporate responsibility regarding consumer policies, and partly to encourage consumers' capability to act rationally and critically in the market.

These changes, in turn, have been necessitated, it is widely argued, by the increasingly complex and highly technical nature of these two markets. Also driving change is the political shift in welfare provision, from a welfare state taking a rights-based approach to a system that targets social insurance on those with specific vulnerabilities, leaving financially-literate consumers to provide for themselves. Hence, the regulation of financial service markets is vital to underpin personal welfare provision, such as pensions, savings, and insurance. In the communications sector, similarly, technological developments, such as digital switchover, broadband spectrum and convergence, are driving a shift from state regulation, strongly influenced by a public service ethos, to the complex delivery of diverse contents and services across multiple platforms to a media-literate public. In what follows, we will explore the development of the FSA's consumer policy and Ofcom's recent work reviewing its consumer strategy and analysis of consumer/citizen interests, in order to shed light on and raise questions about consumer trends in the new regulatory regime.

Regulating financial disclosure

Since its inception, the FSA has produced an impressive body of new consumer research which it makes publicly available as a series of reports.[2] In the foreword to the first of their papers, the then-Head of Consumer Policy and Research, Victoria Raffe, emphasized the regulator's commitment to consumer research: *'Consumer research plays a fundamental role in our efforts to understand better the consumers we are working to help. It helps us to achieve our objective in several ways – identifying areas of potential harm, underpinning and informing policy development across the FSA, helping to prioritise and shape our activities, and measuring the effectiveness of our performance.'*[3]

A key strand of consumer research in the early years of the FSA started from the recognition that a critical issue facing consumers of financial service products was the complexity of decision making at the point of sale. This recognition emerged from the series of recent 'crises' affecting the retail side of the financial services industry: in the pensions crisis, consumers had been persuaded, to their own detriment, to give up occupational pension schemes in favour of personal pensions; in the mortgage endowment crisis, consumers had been persuaded to buy insurance-based investments tied to interest-only mortgages, without understanding the risks on the returns for the underlying investment vehicle. Both these crises were interpreted as resulting in part from the information provided to consumers and their lack of understanding of the products and their associated risks.

This focus on consumers' understanding and decision making at the point of sale led the FSA to commission a range of research projects. Some examined levels of consumer competence in taking advantage of the advice offered, seeking to improve consumer access to product information at the point of sale (examining, for example, the use of illustrations and key fact summaries for complex products), and to rethink the decision trees to be presented to consumers. Complementing the focus on the information used in decision making, the FSA also researched into the social psychological variables (perceptions, attitudes and motivations) that might lead to consumer detriment – for example, research on perceptions of and attitudes towards risk in financial decision making. A further approach was to research consumers' difficulties in relation to financial services (for example, research on consumers' lack of persistence in meeting payments for investment schemes). Taking a different approach, one study commissioned a team of academics from the Loughborough Centre for Public Policy Research to examine the conditions of social/financial exclusion.[4] Continued work in this area has resulted in a number of reports on gender and aging as factors in financial exclusion.

The FSA has also researched consumer understanding of its own activities, since an important part of the FSA's disclosure regime is that firms must make it clear that they are regulated by the FSA. What does this information mean to consumers? Framed by the economic theory of the risks of moral hazard, the concern is that consumers may believe that this disclosure of regulation provides guarantees that it doesn't, or a 'halo effect' in which consumers generalize the guarantee offered to other areas of a firm's activities. Since this research, which indeed provided evidence for both these effects, was conducted while consumer policies (such as for decision trees used in relation to stakeholder pensions) were under development, these insights could be fed into policy developments directly. In a more recent example, the FSA has used other techniques; for example, 'mystery shoppers', to evaluate compliance to its conduct of business rules for payment protection insurance.

Clearly, this programme of consumer research represents a serious and concerted attempt by the FSA to provide an original evidence base for its practices, insofar as these depend upon assumptions regarding the ability of consumers to act rationally and critically, thus aiding the FSA in identifying the potential impact of regulatory intervention on consumer behaviour and financial decision making. Nonetheless, there is some scope for critique regarding the way that consumer research is framed by the FSA.

The research agenda is largely issue-driven, being set by the regulator according to its immediate concerns rather than led by an independent a priori account of the nature and range of consumer issues. This in turn favours the commissioning of professional market research companies over other sources of research (such as academia or the NGO/charity sector), which tends to result in a 'service' approach to the delivery of research (rather than one that draws on theoretical traditions, on complex multidimensional analyses, or on insights from neighbouring or contrasting contexts). The result is a cumulative rather than a testing approach to research, tending to confirm rather than contradict the regulator's prior assumptions, and providing such information as is useful rather than challenging to regulatory practice. For example, research on the effectiveness of the disclosure regime already buys into the assumption that what the consumer needs is information to guide decisions (a cognitive focus on information processing), neglecting the social or cultural conditions (values, norms, social expectations) that frame, and possibly generate, problems for such decisions in real-world contexts.[5]

Ofcom's 'consumer experience'

As with the FSA, Ofcom has invested substantially in consumer research in its first three years, producing an annual Communications Market Report, plus commissioning a range of significant pieces of market research, literature reviews and other studies to feed into the timetable of their major policy reviews.[6] One such study, which we examine here, is a research report on *The Consumer Experience*.[7] As in many of its other documents, this begins with Ofcom's specification of its regulatory principles, organized under the headings, 'When we regulate', 'How we regulate' and 'How we support regulation'.

The 'when' of regulation is formulated in terms of a 'bias against regulation', moderated by a *'willingness to intervene firmly, promptly and effectively when required'*. This basic operating principle is further qualified by the commitment to regulate in those cases in which Ofcom has a specific statutory duty to further a particular public policy that cannot be achieved by markets alone.

'How we regulate' is articulated as a principle-based approach to regulation according to which Ofcom seeks the least intrusive regulatory tools to meet policy objectives, ensuring that regulatory interventions are *'evidence-based, proportionate, consistent, accountable and transparent'* in relation to both regulatory processes (deliberation) and effects (outcomes).

In answer to 'how we support regulation', Ofcom positions itself as an evidence-based regulator insofar as it generates a state of the art analysis of the communications market, *'consult[s] widely with all relevant stakeholders'* and *'assess[es] the impact of regulatory action before imposing regulation on the market'*.

The report focuses on the financial benefits to the consumer of the regulator's efforts to enhance competition in the domains of fixed and mobile telecommunications, internet and digital broadcasting services, balancing these against an account of consumer concerns, understanding and detriment.[8] It recognises that market structures may give rise to consumer detriment, but also that the social context of consumption and the psychology of the consumer can have a negative impact on the consumer experience. The aim is to provide a baseline against which the effects for consumers of the changing communications market can be measured in future years, thus meeting the accountability requirements on the regulator. Four key dimensions of the consumer experience are foregrounded: choice and range; access; empowerment; and protection and consumer concerns.

'Choice and range' weighs evidence of product innovation in relation to measures of consumer satisfaction, concluding that both have increased since 2004, while prices generally have fallen.

'Access' examines the promised universal provision and take up of key services in telephony, digital broadcasting and the internet, showing that while adoption is considerable, there are systematic gaps growing between younger/better off/urban consumers and those who are older, poorer or more rural.

'Empowerment' is measured by awareness of alternative providers, access to comparison information and the capacity to switch providers; findings here are complex, for increasing numbers of consumers are changing tariffs or switching providers but they report considerable confusion in making these decisions.

'Protection and concerns' focuses on consumer complaints and research into key sources of consumer dissatisfaction (for example, 'slamming' – the unauthorized transfer of a customer's account to a new supplier, security issues, silent calls, and telephone scams). Here it emerges that while Ofcom targets rapid and effective intervention as these problems become evident, consumers remain confused regarding the nature and range of regulatory controls that they supposedly could apply to these services themselves.

One puzzle in Ofcom's approach is how it divides the public interest in regulation into consumer and citizen interests (following the specification of its general duties in the Communications Act). A clear understanding of consumer interests has emerged in its first few years, combining the conduct of market research on key policy issues (such as digital switchover, vulnerable consumers and attitudes to public service), the responsiveness to consumer complaints, the ad hoc addressing of consumer problems (such as spamming, rogue diallers), and liaison with the Consumer Panel (most notably by taking up their Consumer Toolkit, produced to audit consumer interests throughout Ofcom's regulatory processes). No such understanding has emerged regarding citizen interests, though the 2005/6 Annual Plan had promised to *'identify and articulate more clearly how the interests of citizens should be incorporated in Ofcom's decision-making process in a transparent and systematic way'*.[9] No report has yet materialised on this, however, though the 2007/8 Draft Annual Plan[10] promises increased use of deliberative processes of citizen consultation.

Certain issues are clearly earmarked as citizen rather than consumer issues, particularly the possible extension of the universal service obligation in telecommunications to mobile and broadband provision and, a very different issue, the future provision of public service broadcasting (via the BBC and also a possible Public Service Provider). Whether this encompasses the full extent of the citizen interest is unclear in Ofcom's vision and, we suggest, clearly contestable from an outside point of view. Particularly interesting is the identification of protections for vulnerable consumers being discursively repositioned as a citizen issue, with Ofcom taking a lead here from the Consumer Panel.[11] Interestingly, in its latest Draft Annual Plan[12], Ofcom offers an economic (rather than a political or social) view of the distinction between consumer and citizen interests, namely that the latter concerns those services that *'society believes should be accessible more widely, bearing in mind that this may mean some consumers have to pay more for those services than might otherwise have been the case'*.[13] Returning to our point regarding the shifts in welfare provision, here Ofcom signals the cost to the consumer of welfare-type provision to vulnerable citizens.

Conclusions

The public interest, or consumer and citizen interest, at stake in the two sectors examined here is central to the statutory objectives of the new regulators of financial services (FSA) and communications (Ofcom) in the UK, with the representation of 'the consumer' (as agentic or confused, as literate or vulnerable) becoming a central component of the regulators' legitimacy for acting in the public interest. We have argued that the definition of public interest is still being worked out, and that a particular, economic-led approach, operationalised in terms of market research, is emerging as dominant. There remain tensions in the regulators' capacity to balance the interests of consumers and industry and, as Ofcom observes in its recent Draft Annual Plan, also in its capacity to balance the interests of consumers and citizens.

- The primary tension is that between the need to regulate a market so that it is competitive and delivers good value to consumers and the need to protect consumers from risks and detriment.
- A second tension centres on the balance between the needs of individual consumers and broader public policy objectives (particularly where these concern welfare provision and social inclusion).
- A third tension concerns the balance between consumer protections (generally applied to industry provision) versus policies created to raise consumer awareness (implemented through information and education initiatives).

The overall bias against regulation, or bias towards 'lighter touch regulation' tends to push the regulatory burden onto the consumer, now required to be financially and media literate in their dealings with an increasingly complex and highly technical market. To the degree that the regulators do intervene with firms in the public interest, they increasingly premise their rationale for so doing on the basis of evidence (for example, evidence regarding market confidence or consumer detriment).

While evidence-based regulation sounds admirable, a critical view of the research conducted by the regulators is vital. Both the expertise required to inform such a critique, and the financial resources required to conduct alternative or independent research, are scarce resources within civil society, leaving it dependent on the regulator's research conclusions.[14] As we have argued elsewhere[15], the regulator's reliance on market research incorporates some little acknowledged biases – a methodological bias towards surveys and qualitative interviewing: favouring that which can be quantified over the qualitative; that which can be reported by individuals over that which causes either unrecognised difficulties for individuals or problems at a societal level; and favouring the broad but superficial sketch over detailed and contextualised accounts of specific circumstances (not only individual but also including specific products, institutional structures or regulatory policies) in which problems arise. One other consequence of market research is to segment the public into the competent majority and the variously vulnerable.

While it may be easier, in public relations terms, to justify regulatory intervention on the grounds of vulnerability than on the grounds of public value or industry critique, the result is a tendency for market problems to be translated into the limitations of individuals or subgroups, rather than of the industries or policies that address them. Indeed, for the regulator this may engender some confusion between the intention of addressing risk of harm and the intention of increasing market confidence. For example, in its current Draft Annual Plan, Ofcom promises to address parents' worry about protecting their children in the online world, along with people's fear of being excluded from the digital environment. While parental worries and people's fear matter, it is the regulator's responsibility to ensure adequate child protection and digital exclusion that is more important. Alleviating fears without addressing the root cause is hardly satisfactory; yet clearly the focus on expressed fears and worries arises from market research, appearing therefore to translate the risks from market or societal challenges to psychological ones.

Also problematic is the interaction between a stress on vulnerability and the use of market research, for self-representation biases mean that people prefer to present themselves as agentic, competent individuals rather than vulnerable and needy, thus risking an underestimation of the nature of any problems for consumers (the same case can be made for the regulator or industry's reliance on consumer complaints as an indicator of problems[16]).

In sum, while both regulators focus strongly on consumer interests, there are reasons to be critical of their approach insofar as it prioritises market analysis (an account of competition), supplemented by an analysis of consumer vulnerability (or detriment). Thus the agenda for consumer research is set by economic regulation, prioritising financial detriment to the consumer over other less tangible, but arguably important, forms of individual and societal detriment. Thus the key themes addressed are whether there is an adequate choice of products at a competitive price in the market, whether there is sufficient access to products and product information for consumers, and whether there are particular consumers (or groups of consumers) who are vulnerable because they either lack access or lack the capacity to make choices in their own interest. The consumer policy that ensues from this approach prioritises provision of consumer information, identification and targeting for vulnerable groups, and evaluation of consumer awareness (or financial/media literacy). These are laudable policies, but the regulators offer little by way of a self-critical account of consumer issues not covered by their approach, or dimensions of the consumer experience that remain poorly served. As we have argued, though the regulators are public-facing their public engagement is largely framed by the processes and assumptions of market research, a lens which imposes a particular filter on what can be 'heard' from the public.

Further, judging whether dimensions of the consumer interest have been neglected or omitted is itself a costly and difficult enterprise for civil society bodies to undertake. The degree to which the regulators' considerable body of market intelligence (including a comprehensive analysis of the economy, of technical developments and of potential sources of risks to market confidence) is not publicly available because it is commercially sensitive, poses yet a further problem for those concerned to ensure that the consumer and citizen interests are adequately addressed.

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