Approaches to Risk and Consumer Policy in Financial Service Regulation in the UK

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Acknowledgements

The *Public Understanding of Regimes of Risk Regulation* project is part of the Social Contexts and Responses to Risk (SCARR) Network, funded by the Economic and Social Research (ESRC).

Abstract

The financial service and communication sectors in the UK have been subject to radical re-organisation, involving the formation of sector-wide regulatory bodies (FSA and Ofcom) with wide-ranging powers and statutory obligations. Although both have responsibilities for assessment and management of risk, their remits go beyond traditional approaches to regulation. Hence, although primarily oriented to economic policy, both regulators address questions of corporate responsibility, balance of stakeholder interests, the public good, consumer representation and public participation. Accordingly, they are undertaking a range of activities, including consumer education and research, public consultation and the involvement of stakeholders in policy review. Focusing on the case of financial services, this paper presents an analysis of two early speeches by FSA directors, one focused on the approach to risk adopted by the regulator and the other on consumer policy. The second part of the paper considers the conceptual issues regarding different modes of risk management in the new regulators, requiring an account of the various levels and forms of involvement by stakeholders and publics in the identification and management of risk. It follows on from the analysis of the speeches to examine the relationship between risk and consumer policy in the practices of the FSA.

Key words

Regulation, dialogue, rhetorical analysis, risk, public awareness.

1. Introduction

Within the SCARR network (1), our project is concerned with public understanding of regulatory regimes in the two areas of financial services and communications. In each of these sectors, a new, conglomerated regulator has recently been formed (the Financial Services Authority – FSA, in 2000 and the Office of Communications – Ofcom, in 2003) (2). These regulators continue many of the traditions and procedures of earlier regulators – being focused on economic policy, concerned to regulate firms, etc. But there are also some crucial differences. Our research seeks to analyse the changing regulatory context within which the public makes decisions concerning, for our first case study, savings and investments, pensions and mortgages and, for our second case, telecommunications, information and communications technologies and broadcasting.

These changes are evident in the shifting boundaries of responsibility between the consumer, the supplier, the regulator and government in the context of a changing regulatory regime. They are also evident discursively in the negotiated relation between "consumers" on the one hand and "citizens" on the other – a distinction we deliberately put to one side for the present by using the term "public" (LIVINGSTONE, LUNT and MILLER, in prep). And they are evident in the new or expanded range of activities linking the regulators and the public, encompassing public education, public debate, other forms of public engagement and participation and a renewed discussion of "public value" (particularly relevant to the welfare aspects of financial service provision and the public service and universal service dimension of communications).

These changes are complex and are still being worked out by the regulators and stakeholders. However, they clearly involve a diversification of regulatory activities and a broadening of scope to encompass sector-wide issues beyond the level of the firm. They also seek a uniform approach to regulation across the sector rather than evolving regulation piecemeal in response to issues in specific sub-sectors, as was the case for traditional regulation. However, the FSA and Ofcom are creatures of statute, being brought into being by legislation and being bound by a range of statutory obligations. There are potential tensions, therefore, between the broader activities of the new regulators and the constraints and limitations on their activities arising from their statutory background. This may have the consequence of raising public expectations of regulation that the regulators may lack the power, resources or mandate to achieve (SKIDMORE, MILLER, & CHAPMAN, 2003).

We summarise the underlying regulatory changes thus:

Former Regulatory Regime	Emerging Regulatory Regime
Traditional	Post-Traditional
Hard	Soft
Direct	Indirect

Rulebook	Oriented to self-regulation

Table 1: Changes in Regulation

This paper presents an analysis of two speeches made by Financial Services Authority (FSA) directors in the early days of the regulator. An analysis of the speeches reveals the focus on risk in the regulator and its relation to public policy. We then ask how the FSA's approach to risk fits with social scientific theories of risk. The paper offers only a partial account of the FSA's approach to risk, focusing on two selected speeches given in the early days when the regulator first set out its task to the wider policy community – one by the Managing Director and Head of Financial Supervision at the FSA, and secondly a speech given by the then Director of Consumer Relations at the FSA.

- Speech by Michael Foot, Managing Director and Head of Financial Supervision, FSA - entitled *Our New Approach to Risk-Based Regulation – What Will be Different for Firms* (FOOT, December 2000).
- Speech by Christine Farnish, Director of Consumer Relations, FSA – entitled *Getting a Fair Deal for Consumers* (FARNISH, December 2000).

These speeches are aimed at a variety of audiences; primarily firms and public representatives but also at the government, to whom the regulator is ultimately accountable. In the new regulatory climate, the regulators seek to be transparent and informative in their communications with interested parties. In a sense, the speeches themselves reflect the duality of functions of the new regulators as they relate to firms positioned in a complex market and at publics as citizens and consumers. We focus here, then, on an analysis of the arguments deployed in the two speeches. The analysis is guided by the following research questions:

- What is the FSA's approach to risk analysis and assessment?
- How does the FSA's risk strategy lead it to interact with commercial and public representatives?
- What implications are there for public education, empowerment and protection?
- How far and in what ways does the FSA's risk strategy meet public expectations?

Table 2: Research questions guiding analysis

2. The FSA's Approach to Risk Analysis and Assessment

Delivered 12 months before the establishment of the FSA, but 6 months after Royal Assent was granted to the Financial Services and Markets Act, 2000, the opening passage of Foot's (2000) speech maps out the FSA's general approach to risk and regulation thus:

- "*To achieve a more consistent form of regulation, and a more cost effective allocation of our finite resources across the whole range of financial services*" (Foot, 2000: Paragraph 3)
- Another important general operating principle is the intention to be more proactive than traditional regulators – "*to warn off and head off things before the event*" (Foot, 2000: Paragraph 3)
- The focus of activities is intended to be more "thematic", with "*a reduction of resources we deploy on day to day supervision of firms in order that we can release people to spend more time on thematic and industry wide work*" (Foot, 2000: Paragraph 3)

Table 3: FSA approach to risk

The extracts highlighted in Table 3 employ the rhetoric of progress to warrant the particular forms of regulation being promoted by the FSA. Previous styles of administration are implicitly criticised: the new system will "achieve a *more consistent* form of regulation" (emphasis added); new models are thereby portrayed as overcoming the failings of the preceding arrangements. Three areas of improvement are identified. Industry-wide consistency (implying previous inconsistencies) is promised, meaning that no single area of financial services will be left un-regulated; the even distribution of resources across the sector is mentioned, suggesting that areas that were previously neglected will now be attended to; tactics aimed at prevention (rather than cure) are signified, reflecting the broader cultural commonplace of healthy organisms—in this case non-organic ones—whose wellbeing is guaranteed through pro-active measures. Underlying these changes is the ethos of liberalism (firms will no longer be under close supervision) and efficiency; the reforms will 'release people' so that they can do more relevant work. Less intervention is advocated, with industry-wide efficiency, security and health being the areas of concern.

Having established a rationale for the changes to financial services regulation (via the rhetoric of progress, efficiency and health), the proposed policies of the FSA can be promoted without much justification. These reflect the general operating principles to be brought to bear by the Financial Services and Markets Act, 2000. FOOT (2000: Paragraph 4) summarizes these as:

- Market confidence
- Public understanding
- Consumer protection
- Reduction of financial crime

Table 4: Principles of Financial Services and Markets Act, 2000

Foot (2000) argues that it should not be presumed that the aim of regulation is to eliminate risk altogether. The FSA adopts what Foot (2000) admits is a specialized use of the term 'risk': [4]

"That [risk] is nothing to do with commercial risk taking, which of course is a key aspect of the financial sector's activities. It is not our role to restrict appropriate risk taking in authorized firms; our model is concerned with the risk that the FSA will not achieve its statutory objectives" (FOOT, 2000: Paragraph 4).

To understand the concept of 'risk' in this context, it is important to identify the parameters of the FSA's statutory objectives and to clarify how these might be threatened. These provide the logic for the FSA's guidelines—as does the broader ethos of progress, preventative health and administration aimed at maintaining market confidence described above. Various risks are identified:

- Risk to market confidence
  - The financial collapse of a significant number of firms
  - A significant market malfunction
- Risk to public understanding
  - Inadequate general financial literacy
  - Inadequate understanding of particular goods and services
- Risk to public protection
  - Resulting from Misconduct/mismanagement of institutions (e.g. failure to control sales forces)
  - Resulting from financial crime or market abuse
- Risks to the reduction of financial crime
  - Fraud
  - Money laundering

Foot, 2000: Paragraph 5

Table 5: Risks identified by Foot

Next, Foot (2000: Paragraph 6) identifies three likely 'sources' of risk (see Table 6) denoting how the regulator characterises risks; rather than choosing a narrow form of risk characterisation, the FSA recognises that risks emanate from several 'avenues'. By embracing a broad form of risk characterisation, the FSA demonstrates that it is willing to acknowledge the complexities and challenges of assessing and managing such risks.

- The external environment
- Public and industry wide risks
  - E-commerce
  - Specific problems with particular products
  - Vulnerable members of the public
- Individual financial institutions

Table 6: Sources of risk

The importance and priority of each risk is to be determined through an assessment of:
The impact on the FSA's objectives, should the risk occur;
The probability of the risk occurring;
An integration of these impact and probability analyses.

Much of the detail in Foot's speech, however, is focused on the affect of regulation on industry; questions of how sector-wide issues and externalities are dealt with are less clearly specified. Impact analysis is oriented to the statutory objective of maintaining market confidence: the FSA conducts risk assessment for the roughly 11,000 firms in the financial services sector, as well as for specific cross-sector issues (e.g. credit card risk). Impact analysis involves assessing the potential scale of risk by measuring market share, the number of people potentially affected, the resources (mainly financial reserves) of the firm available to cope with the consequences, and so forth. (3) On the basis of this analysis, firms are to be categorised as high, medium or low impact.

Each firm (again the implication in the speech is that this exercise can in principle be applied to products or sector wide developments) is rated for the probability that risks may occur. Probabilities are calculated using a basket of measures of the practices of firms, and in making judgments about the management processes of firms, the FSA's other statutory objectives also become salient. For example, the managerial competence of the firms is considered (a public protection issue), together with issues of control and communication at the point of sale (related to public understanding) and issues of product failure (relevant to public protection and to financial crime).

Foot (2000: Paragraph 9) divides the factors that potentially increase risk in financial service firms into business risks and control risks:

- Business risks
    - Market, credit operation, legal risks, financial soundness, strategy and measures based on customer's products and services
- Control risks
    - Marketing, selling and advice practices, systems and controls, organizational factors including measurements of quality of staff and board

Table 7: Categories of risk

Lastly, aggregate statistics are produced that combine impact and probability classifications to identify firms that are high to medium impact and high to medium probability, and this provides the basis for the allocation of regulatory resources. Thus, although the consistent application of risk analysis to firms and products as a means of regulatory classification is a new departure in the regulation of financial services the FSA adopts a traditional approach to risk assessment whereby measures are taken of the

potential impact of risks and the probability of occurrence of risks so that risky firms and products can be identified in order to prioritise regulatory activity to secure their objectives.

These analyses are used to shape the relation between firms and regulators. While not intended for publication, they form the basis of a dialogue between the regulator and firms. Firms or products that score high on impact and probability scores are more likely to be subject to traditional modes of regulation, inspection and auditing. Low to medium risk firms and products are expected take steps to deal with identified business and control risks as part of a system of self-regulation.

These analyses are also used to guide the allocation of regulatory resources over and above specific regulatory activities aimed at particular firms. As Foot (2000) notes, the new regulatory regime includes a shift in emphasis away from firm-specific regulatory activities towards *"consumer orientated and industry wide activities"* (FOOT, 2000: Paragraph 14), for reasons of focus and efficiency (this shift being recognised by statute) (4). For example, it is considered preferable to improve the public information campaigns accompanying product development than to deal with claims of miss-selling later. Consequently, an important distinction is drawn between compliance rules, which apply to all firms regulated by FSA, and assessing engagement in the broader regulatory activities of authorization, base-line monitoring, sectoral review/thematic work, monitoring of specific institutions to mitigate specific risks, and response to crystallization/escalation of specific risks (FOOT, 2000, Paragraph 18).

Overall, these changes in regulatory practice aim to provide incentives for self-regulation (including encouraging firms to implement public-oriented policies and to identify risks before they escalate into crises) while traditional regulatory activities are targeted at potentially high risk firms and market developments (and at developing technically sophisticated means of monitoring and analyzing indicators of cross-sector risk to the FSA's statutory objectives). From its inception, the FSA was aiming to provide an incentive to firms to move towards self-regulation; those that managed risk well would be given relative freedom, with a reduction of rule-book regulation on issues apart from those with an ethical dimension.

3. The FSA's Consumer Policy

At the time that Foot provided a public account of the FSA's risk based competition policy, Christine Farnish, the FSA's Director of Consumer Relations, gave a speech detailing the FSA's view of its statutory objectives regarding consumer relations. Entitled *Getting a Fair Deal for Consumers* (2000), the speech begins with a reminder of the principle that, since risk cannot be entirely excluded from the financial services industry, regulation should not aim for a zero risk environment.

The FSA's approach is governed by the perceived need to balance a fair deal for consumers against the potential burden on industry (including the financial and regulatory burden). Hence Farnish (2000) argues that the regulator should seek to limit the impact on consumers of risks arising from the management and control procedures of firms by

requiring firms to manage and facilitate public understanding and public protection, but *"without placing such an onerous burden on providers that innovation and competition are stifled"* (Paragraph 2). This need to ensure that there isn't an 'onerous burden' on financial services suggests that industry's obligation to the public is limited; according to this perspective, after a certain point, the public is responsible for its own wellbeing. The language used signifies the oppressive impact of over-regulation, thereby legitimating the economic policy approach advocated by the FSA. Consumer protection, in other words, is only relevant in such cases that events pose an immediate, widespread or potentially costly threat to consumers (and thereby to the FSA's key statutory objective of market confidence). As Farnish puts it:

"prevention is better than cure, and in our view having better informed, more financially literate, consumers is the best way to achieve an environment in which normal market mechanisms can work to drive up quality and value" (FARNISH, 2000: Paragraph 2).

This passage combines two kinds of ethos: the rhetoric of health and development are combined to construct a scenario in which educated consumers complement a healthy market. The rhetoric of health is used in this extract to promote a focus on public education. Market instability is attributed to a lack of public awareness rather than product dissatisfaction; efforts are made to put a positive spin on this message, so the suggestion is that risk would be minimised through information campaigns and that everyone would benefit from the market operating independently. Intervention is advocated, but not the kind that would lead to the stifling of creativity described earlier; the aim of regulation is to head-off risk before it materialises and to ensure that public education is improved. As we shall see below, previous crises in public confidence are attributed to confusion on the part of the public, rather than arising from problems with the product itself (the above extract also presents the public as having been previously ill-informed and financially unaware). From the FSA's perspective, public awareness can be improved through effective communication; to achieve this, information asymmetries between firms and consumers need to be addressed, and the balance between public and industry established, whereby customers understand that risks are inherent in financial contexts. As we will see, this reflects an underlying ethos of preventative and precautionary regulation (rather than rule-book administration).

While Farnish (2000: Paragraph 3) acknowledges the difficulties often raised by industry representatives (that financial service products are complex, the potentially high costs of meeting unfettered objectives in public understanding), she outlines the FSA's mixed strategy as including:

- Long term promotion of public understanding (to facilitate effective public decision-making)
- Intervention in crises as they occur (e.g. the pensions crisis, mortgage endowment miss-selling)
- A focus on provision of information and management of the point of sale (by the regulator, the industry and by public representative bodies) with a

particular emphasis on emerging products (e.g. stakeholder pensions)

Table 8: FSA strategy to risk

4. Responding to Crisis

In the years immediately preceding the formation of the FSA there were a number of financial crises. These are often cited in speeches and policy documents, since they illustrate the problems of traditional regulation and because, by giving prominence to the kinds of financial risks facing consumers, they illustrate the FSA's new approach (engaging in consultations and discussions to help firms interpret their obligations, developing policy tools to assess, evaluate and manage risks in financial services, bringing issues to the attention of the consumer and enhancing public understanding). Farnish (2000) illustrates the FSA's approach to consumer policy (above) with an account of the response to the emerging crisis over endowment mortgages (5). From 2000-2002, the FSA set itself the aim of increasing public awareness of the problem (while avoiding contributing to a potential media-based panic that might lead consumers to cash in their endowment policies on unfavourable terms) (6). This aim relied heavily on the expectation that, given widespread adverse publicity and growing public awareness, it would be in the interests of firms to resolve issues around potential miss-selling quickly and fairly.

Yet, as Farnish (2000) acknowledges, critics have argued that the FSA should have undertaken a wholesale review of all mortgage endowment sales, particularly since companies may have been slow in making consumers aware of their financial position and rights, partly by using legalistic, defensive tactics in response to consumers' complaints. Moreover, it seems that firms have not (yet) resolved the problems as hoped, perhaps optimistically, by the FSA. Consumer representatives continue actively to campaign on these issues and, more recently, FSA policy has shifted towards consumer compensation (7). As Farnish (2000) concludes ruefully,

"Our work on endowments – like the pensions review – has exposed the industry's customer relations and communications to the harsh glare of publicity, and I am afraid to say that those customer relations services in many firms have been found wanting" (FARNISH, 2000: Paragraph 5).

Have lessons been learned? The FSA hopes that firms have learned that improvements are required in customer relations (e.g. providing regular feedback on the performance of investments) and in complaint handling by firms (Farnish, 2000: Paragraph 6). The FSA too has reviewed its own actions, introducing new guidelines on fair and efficient complaint handling, together with a requirement on firms to submit regular returns on volumes and types of public complaints received by them. However, as befits their consumer policy, the FSA is also concerned to improve consumer awareness and understanding of the potential costs and benefits of financial service products. Their work towards this goal includes (Paragraphs 7-9):

• Research on awareness and public understanding (which consistently

demonstrates deficits and failures in current provision of information)
- The production of comparative tables within particular markets as an aid to public decision-making
- A review of documents and other forms of contact with consumers
- Establishing a task force on the use of past performance data in financial service advertising
- Promoting the teaching of financial literacy in the national curriculum (and developing appropriate teaching resources)
- Developing a web-based advice services (e.g. choosing financial service products, stakeholder pension decision trees, etc)

Table 9: FSA's public awareness strategy

Undoubtedly, preventing crisis represents a significant challenge to the regulator. However, in the domains of financial services, 'crisis' is to be understood not only as the potentially catastrophic emergence of a specific risk event (as in the domains of chemical hazard or food risks, for example) but rather as the gradual emergence of a preventable problem. Such a crisis may fall short of the criteria for market failure but nonetheless have an insidious effect on consumers, which may in turn affect market confidence. Hence there is indeterminacy between the language of risk assessment developed in Foot's speech and the language of prevention or precaution in that of Farnish. Consequently, as a whole, the FSA's risk policy balances commercial and public interest in order to address issues of management, control and public relations on the commercial side and public awareness, understanding and decision making on the public side. We have seen that this issue plays out in the complex relations between crisis response and statutory obligations in the regulators. In all this there is a promissory note concerning the future effectiveness of the regulatory regime adopted by the FSA – that more systematic risk analysis, smarter regulation balanced by consumer protection and enhanced by public education will lead to a reduced tendency to crisis in financial services.

In considering whether the FSA's strategy (Table 9) is sufficient and likely to be effective, a pertinent question given the critical scrutiny it is under from both firms and public representatives, it is worth identifying the key features of the crisis over mortgage endowment miss-selling. What, in short, does the case of mortgage endowment miss-selling reveal about risks in financial services and about the relation between the regulator and the public? We can identify a range of issues facing all concerned – the regulator, firms and consumers themselves:

- The problem was sector-wide, establishing the need for monitoring the whole sector rather than periodic checks on particular firms (8)
- Multiple factors combined to produce a complex problem (e.g. the projection and past performance of products, issues to do with incentive structures, disclosure, public understanding, managing the point of sale) (9)
- The problem originated at a time of relatively high (and volatile) interest rates, these providing a poor basis for long-term projections

- The issue took a long time to emerge, building up slowly to an apparently unstoppable crisis of considerable proportions
- It has been difficult to achieve a consensual view of the causes and extent of the financial detriment to consumers.
- It is possible that suppliers and consumers had systematically different interpretations of the risks inherent in the products (10)
- There has been much coverage of the issue in the media, both raising awareness but also potentially encouraging public panic
- Consumer representative bodies have made the issue a campaigning issue, raising key issues of public protection and awareness
- Consumers faced some considerable 'financial literacy' challenges in terms of making appropriate risk assessments and future projections
- Consumers required considerable scepticism at the point of sale, if they were to assess the clarity, fairness and truthfulness of information (11)
- With hindsight, consumers appeared to trust firms rather than act as critical consumers

Table 10: Risks in Public Services

It is open to question whether the FSA's work plan for consumer policy is sufficient to cope with these challenges.

5. Theorising the FSA's Approach to Risk Management

Mapping the risk management strategies of the regulator as they relate to the public is no easy task. Across the range of their activities, the FSA adopts a varied approach to risk management, from direct regulation of firms and products classified as high risk to promoting public awareness and financial literacy in the longer term. The FSA is directly involved in public education and the provision of information and advice, working alongside public representatives with specific campaign objectives. Thus far we have articulated the FSA's official view. We now seek to consider this official view in relation to academic research on risk as part of our critical analysis of the changing relationship between regulators and the public. To take the analysis forward, we draw on Ortwin Renn's paper, *Risks and Society* (RENN, 2000), as this offers a framework for analysing the various dimensions of risk evident both in the public statements of risk policy (e.g. FSA speeches, as outlined earlier) and the particular case of the FSA's intervention over the crisis in mortgage endowments.

RENN (2000) argues that there is a potential conflict between risks as assessed by experts or regulators and risk perception by the public. Policy makers face the following dilemma: taking a lead from the public might result in unacceptable costs to the industry (and regulator), but taking a lead from expert/regulatory analysis might lose public support and increase public apathy. Such a polarisation of perspectives is symptomatic of the "legitimation crisis", (HABERMAS, 1988 & 1991), of late modernity for it is fuelled by problems of communication between representatives of the system world and the life world; each has its own norms. Though not without his critics (CALHOUN, 1993;

OUTHWAITE, 1994), Habermas advocates a rapprochement based on a combination of rational decision-making procedures with public engagement in a context free forum the strong interests of administrative as well as personal interests. Translated into policy terms, this suggests the value of mediation – under carefully managed conditions – between policy, commerce and consumers. How shall this be achieved?

As we have seen with the FSA, the key policy imperative is to identify a sound basis for understanding risk in order to prioritise the allocation of regulatory resources. In seeking a practical resolution of problems arising from the complexity of issues surrounding risk analysis RENN (2000) distinguishes between risk assessment, risk evaluation and risk management:

- Risk
    - The possibility that human actions or natural events lead to consequences that affect aspects of what humans value
- Risk assessment
    - The scientific process of identifying unwanted consequences (and their causes) and calculating their probabilities and magnitude
- Risk evaluation
    - The process of determining the acceptability of a given risk
- Risk management
    - The process of reducing risks to a level deemed tolerable by society and assuring control, monitoring and public communication

Table 11: Ways of dealing with risk (Renn)

Working primarily within the domain of natural hazards, RENN (2000) argues that multiple factors increase the potential impact and probability of negative consequences. These include increasing populations and population densities; increase in social risk and decrease in technical risks; coupling of risk sources; increased emphasis on non-fatal health risks; and so forth. These features, which RENN (2000) suggests are typical of the risks confronting contemporary society, mark an important departure from the traditional characterization of hazardous (e.g. chemical) risks – in terms of potentially life threatening, technical/organic problems, with identifiable single causes and localized impact. We can translate RENN (2000) features of contemporary risks (rather than hazards) into the language of financial services as follows:

- Increasing exposure to financial service products and their associated risks, because of -
    - Increasing personal wealth
    - Shifts in welfare provision to more personal funding of welfare
- Social risks in financial services
    - Social comparison
    - Knowledge gaps in public understanding
    - Mis-selling and communication problems
    - Product base for low income groups

- Relationship breakdown
- Coupling of risk sources
  - Diversification of product exposure (portfolio effects)
  - Interaction between externalities and the underlying risks of investments
  - Interaction between selling practices and public understanding
- Non-extreme financial and welfare risks
  - Values and lifestyle threats
  - Level of welfare provision
- Global markets
  - Global economic risk
- Transfer of risky financial service products to vulnerable groups
- Longer term cycles and trends
  - Changes in welfare provision
  - Low interest rates
  - Aging
  - Relationship breakdown
  - Growth of expectations
  - Changing social values (individualization)

Table 12: Types of Risk

If we were discussing the domain of hazardous events, these factors would not traditionally be considered directly within a risk assessment but rather they would represent the background conditions against which risk assessment, evaluation and management take place. Yet when faced with non-hazardous forms of risk, which are more diffuse and less acute, it might be argued that these factors are crucial to the assessment of risk itself. For example, in the endowment mortgage crisis, it has never been suggested that there was a problem with the actuarial work on projections. Rather, the mis-selling problem arose from the choice of parameters framing the explanation of these projections to consumers at the point of sale, compounded by slow reactions from firms in updating projections of investment performance. In other words, a broader, public-oriented analysis of risks should be included in risk assessment (where this is currently driven by actuarial assessments).

Hence, while for RENN (2000), risk evaluation bridges risk assessment and risk management, taking the results from assessment and translating them into goals for management (see Table 12), we suggest that risk evaluation interacts with the management of risk (by firms and regulators), thereby feeding into risk assessment (12). It is a moot point as to whether the factors we identify as combining to create risks in financial services (other than the risks arising exclusively from changing economic circumstances) are best understood as components of risk assessment or risk evaluation (in Renn's terms). Irrespective of this, for financial services a broader set of challenges lie ahead for risk assessment/evaluation. These include:

- Consideration of psychological, social and cultural detriment

- A more integrated approach to consumer risks (across products)
- An analysis of the potential impacts on diverse (stratified, vulnerable) consumers
- The development of tools to describe underlying risks (e.g. ‘traffic lights’)
- The transfer of expertise in risk assessment to the presentation of risks at the point of sale
- Development of forgiving technologies/products to provide access to variations in investment vehicles and relate these to the presentation of product risks

Table 13: Challenges for those assessing risk

RENN (2000) proposes a traffic light system in which a green light is given if all risk evaluation factors are set at a relatively low level; if a few parameters are intermediate or high, a yellow light would be allocated, and if more factors register as highly likely, then the risk is intolerable (red light). For the public in this proposed regime, the product might be given yellow or red as a result of high ratings on a broad range of risk factors including issues of risk evaluation even though the traditional measures of impact and probability would have suggested a green light. For example, in the mortgage endowment crisis, the point of sale information was based on an actuarial concept of risk, but the public most likely understood the information presented very differently, assuming a much broader assessment of relevant risk parameters had been made, with a different consequent risk evaluation. Indeed, had this broader range of factors been considered, a yellow or red classification would have applied (13).

In short, and echoing Renn’s legitimation problem, it seems that under conditions of uncertainty, the potential for miscommunication is rife between experts (who favour the language of actuarial analysis) and publics (who speak the language of personal risks). What are the implications for risk management? RENN (2000) argues for a distinction between risks that are well served by traditional, technical risk assessment and risks that require the adoption of precaution-based management. In the latter case, regulation may be required even when no risk is indicated by traditional measures of impact and probability. This may apply either when the consequences of a decision are uncertain or, although the consequence of a decision are certain, there are different interpretations of the potential outcome – in short, when the outcome is ambiguous (and so requiring ‘discursive risk management’ to reduce misunderstanding). If we follow this line of argument, one may suggest that the mortgage endowment selling crisis was an example of uncertainty (in terms of long-term projections). But, where RENN (2000) sees ambiguity arising from differing interpretations of the outcome, we suggest instead that this case revealed ambiguity of a different kind, for what was critical were the differing interpretations (between financial advisor/seller and public) of what was on offer in terms of risk analysis and risk evaluation. [8]

The issue is best understood as a meta-cognitive one: there was miscommunication about the nature of risk in explanations of product performance given to the public. From the firms’ perspective such explanations are reasonable in that they show what can be known with certainty about the relation between performance of the product and interest rates;

uncertainties are handled as assumptions and thus cannot be accounted for. From the public perspective, the explanation was not understood simply as a simulation of the known performance characteristics of the product but as projections of the potential performance of the product. In other words, the consumer does not recognise the distinction between uncertainty and certainty and it may be that they assume that the explanation contains an assessment of the probability of the product' s success. It is open to question whether consumers can understand the distinction between the function of the product and the parameters of uncertainty in such an explanation. It is also a moot point as to how clearly the advisors at the point of sale were aware of this fundamental difference between public and industrial perceptions of product performance. The basis of the miscommunication on this reading does not reside in the expression of different modes of reasoning (instrumental and social logics) as suggested in Renn' s account, but a fundamental misunderstanding of the industrial model of risk.

'Discursive risk management' (or more investment in risk communication) should, on Renn' s view, be extended to embrace all aspects of risk as they relate to the interface between consumers and stakeholders. If this does not occur, and if the basis of risk assessment remains narrowly technical, we may assume that the broader risks accompanying product purchase will be fleshed out by the advisor and the consumer in the course of their communicative interaction: herein lies the potential for (unaccountable) mis-selling and public dissatisfaction. The FSA' s response has been to develop better control procedures in firms and to enhance public understanding of risk. Yet we have suggested that this may be ineffective, unless the underlying miscommunication in terms of (mis)understandings about risk assessment and risk evaluation, particularly but not solely, at the point of sale are addressed.

It seems that the new regulators, FSA and Ofcom, follow a weak adoption of the Precautionary Principle (SUNSTEIN, 2003). This is seen in Foot' s speech (2000):

"We will be guided by the legislation; we have principles of good regulation set out in the statute, we will be placing increased emphasis on consumer orientated or industry wide activities as alternatives to institution specific activities, and that is because we believe that they're very often more efficient and more effective in responding to many risks. So for example, a consumer information campaign which alerted consumers to the risks and returns inherent in a new product might help from the outset to prevent mis-selling, it would be much more costly to leave it until later to put right". FOOT, 2000: Paragraph 17).

The FSA therefore face such issues as, what are the more or less risky alternatives, and who should take responsibility for them (14)? They must also ask, what can be expected as a ' rational' response from the consumers of financial service products? And they must ensure provision for adequate margins of safety in all decision-making. In asking such questions, the Precautionary Principle can be seen to undergo a shift from a formal concept in risk management theory to a principle to which citizen-consumers are now expected to subscribe as part of everyday life (15). For example, Farnish (2000) discusses how the aim of the FSA is to, *"ensure that consumers are provided with the information they need, not only to understand what's going on, but also to help them make*

informed decisions about what they should do…" (FARNISH, 2000: Paragraph 13). She refers to learning from past mistakes, referring to how the FSA responded to mortgage endowments: "*Our aim was to ensure that consumers were well informed, are prompted to take appropriate action, but weren't panicked by media scare stories*" (FARNISH, 2000: Paragraph 14).

Achieving such goals remains a difficult task, leading one to wonder how, when balancing stakeholder interests and seeking risk assessment in the financial services and communications sectors, do regulators determine what levels of risk are acceptable? How are thresholds and levels of acceptability defined, and by whom? It seems that in the new culture of regulation, the Precautionary Principle represents not just a mechanism for dealing with uncertainty. It also offers an approach for dealing with less tangible forms of risks and conflicting stakeholder interests. In these contexts, social/cultural uncertainty is substituted for scientific uncertainty and is mitigated against through the kinds of rhetorical strategy described above.

Adoption of the Precautionary Principle has not been without its critics. SUNSTEIN (2004), in opposing the widespread implementation of the Precautionary Principle by European regulators, claims the principle to be incoherent, since "it purports to give guidance, but it fails to do so, because it condemns the very steps that it requires" (SUNSTEIN, 2004: pp. 2). Precautions always give rise to new risks and are open to socio-cultural variations in application, meaning that it ends up being inconsistent—especially since different risks are priorities for different populations (SUNSTEIN, 2004: pp. 29), leading us to question how regulators can "ensure" that citizens and consumers take appropriate action in response to potential risks.

6. Emergence of a "Looser" Form of Risk Management

Notwithstanding these and other criticisms, the new culture of regulation is adopting the Precautionary Principle in promoting engagement with stakeholders, participatory dialogue with the public and the provision of information to make the public "better informed". This use of the Precautionary Principle has developed hand-in-hand with the transition from previous "hard" forms of risk management and regulation towards "soft" regulation. Arguably it has provided a way forward for advocates of soft regulation concerned that more stringent forms of regulation are no longer sustainable, given privatisation, globalisation, a distrusting public, and so forth. In this new culture, "communication" is central to the new, "looser" form of risk management.

In parallel, it is noteworthy that the risk management techniques employed within the new culture of regulation reflect a significant transition within academic risk research. Traditional risk theorists allied to the psychometric paradigm (e.g. SLOVIC, 1987) emphasised the gap between lay and expert knowledge, leading the way to an easy characterisation of the public as foolish or irrational. Research in this tradition has thus sought to improve policy-making by increasing public understanding of risk and improving the communication of risk information between the public, experts and decision makers

(SLOVIC, 1987). How, they have asked, can expert's knowledge be disseminated to the broader public so as to close the growing knowledge-gap between them?

OTWAY and WYNNE (1989) stated that the general paradigm of risk communication has focussed upon unexamined and unarticulated assumptions about who is communicating what, to whom, and in what context, resulting in an overly-simplistic approach to risk communication issues (PIDGEON, 1997). As SLOVIC (1987) has observed, traditional risk communication efforts have failed to curtail major conflicts or reduce much of the dissatisfaction with risk management due to their failure to recognise the social and contextual complexities associated with risk and its management (SLOVIC, 1997). Indeed, it has been argued that risk communication is "at a crossroads" (OTWAY & WYNNE, 1989).

More recent research has stressed the importance of two-way communication and public participation in mutual learning and decision-making, thereby increasing trust (e.g. LOFSTEDT, 1996). Thus, modern approaches stress the importance of factoring in public reactions to risk and of genuine two-way interaction between experts and laity in order to reach a common view on risk. While our present context includes there are many more social actors than "experts" and "lay people", it seems that the new approach to risk management adopted by the FSA and Ofcom reflects this shift in risk literature, providing a "working example" of two-way dialogue and public participation.

Much of this may, however, sound rather idealistic as an approach to risk management - involving a two-way exchange of information, with rules to ensure a just and fair process, and participation of all parties in decision-making (i.e. "mutual understanding" as opposed to "exertion of power" (GUTTELING & KUTTSCHREUTER, 2002)). In particular, there are clearly some difficult challenges to the general framework of regulators acting as a forum for the discursive management of conflicts over responsibilities for risks (in this case between public, industry and regulator) not least because the regulator is also a stakeholder in financial service provision. These activities and the broader set of activities of the regulator clearly go well beyond the specification of discursive risk management strategies in the face of ambiguities over evaluation of risks as articulated by Renn in his account of the precautionary principle.

7. The Challenges Ahead

The issues raised in this paper raise several challenges for the new regulators (listed in Table 15). In many respects these challenges epitomise many of the ongoing debates in the arena of risk research. As we have seen, the formation of new regulators has been mirrored by changes in regulatory styles. This in turn has lead to the adoption of novel techniques for risk management in light of uncertainties regarding the ubiquitous nature of risks themselves. We have suggested that the use of precautionary measures is gaining prominence, thereby allowing regulators to adopt a position in which there is no 'right or wrong' as such. In this context adoption of precautionary approaches coincides with a 'loose form' of risk management where emphasis is more upon decision making approaches and generating dialogue. Thus, regulators acknowledge that the aim of

regulation is not to diminish risks altogether (indeed the achievement of zero-risk is recognised as being near-impossible). Rather, on the basis of previous mistakes, their aim is to ameliorate conditions for dealing with risks; in doing do, ultimately their aim is to reconcile the interests of markets with those of the public. This is guided by the statutory obligations of FSA and Ofcom to combine issues of market regulation with questions of public interest. This is a further example of the interesting and novel ways in which new forms of regulation are undertaking their responsibilities, and demonstrates how they aim to consolidate both interests.

- Risk characterisation
  - The nature of the "risks" themselves – they are not self-contained, they are ubiquitous
- Reaching out to the public
  - Public participation and civic engagement (16)
- How to operationalise civic engagement?
  - Provision of information: Promoting awareness of issues
  - Protecting the public (17)
  - Incorporating public opinion into decision making processes and risk assessment (18)
- Implications for risk communication
  - 'One-way' vs. 'Two-way' Models for Communication (19)
  - Capacity building, integration and public discussion
- Role of the media
  - Amplification/Attenuation (20)

Table 14: FSA's conceptualisation of Communication with the public

In terms of 'reaching out the consumer', the regulators attempt to encourage public participation and civic engagement. For both FSA and Ofcom, these are key aspects of their operating principles, where new relationships are being forged between regulators and citizens in risk management.

In addition, citizens and consumers are encouraged to use a precautionary approach in dealing with, potential risks. We have seen how the FSA aims to make consumers more aware and to educate consumers to be more literate so that they are in a position to weigh up potential risks of such products. Emphasis is also placed upon firms taking a precautionary approach to interpreting projections and forecasts; in other words, industry has a duty to inform the public in a clear and fair manner. Issues of responsibility therefore pervade current regulatory discourse; the public and service providers each have specific duties with regards financial arrangements. This form of risk management deviates from previous one-way approaches (e.g. experts/firms – consumers), and relies on dialogue between social actors.

The new variety of regulatory activities involves dverse relations with a network of key actors involving a range of communication issues from the provision of information and generic advice to the regulator positioning itself as the public sphere for discussion of consumer and regulatory issues in financial services/communications. Our project aims to map these activities, relations and themes as a background to examining public understanding of regulation.

8. Endnotes

(1) Social Contexts and Responses to Risk (url: http://www.kent.ac.uk/scarr/)
(2) The Financial Services Authority (FSA) (url: http://www.fsa.gov.uk/) assumed its full powers and responsibilities in December 2001, having gained statutory status under the Financial Services and Markets Act, 2000. It is the UK's sole financial regulator, having replaced the work of several bodies (the Building Societies Commission, the Friendly Societies Commission, the Investment Management Regulatory Organisation, the Personal Investment Authority, the Register of Friendly Societies, Securities and the Futures Authority). The Office of Communications (Ofcom) (url: http://www.ofcom.org.uk/) is the independent regulator for the UK's communications industries. Formed under the Communications Act, 2003, the regulator assumed its statutory powers in December of that year. The formation of Ofcom replaced five existing regulators: the Broadcasting Standards Commission, the Independent Television Commission, Oftel, the Radio Authority and the Radiocommunications Agency.
(3) Little of this is new, and the FSA collects such data as a matter of routine, reviewing the available sources of data periodically to see if alternative or additional statistics are needed.
(4) To further its aims of encouraging self-regulation and increasing the salience of the consumer, the FSA deploys four classes of policy tool (FOOT, 2000: Paragraph 14):

Diagnostic tools
assessment and measurement of risks (e.g. routine visits or external expert assessment)
Monitoring tools
Tracking the development of a particular risk (e.g. monitoring returns)
Preventative tools
To limit or reduce risk (e.g. providing comparative information to consumers)
Remedial tools
Response to crystallized risks (e.g. restitution, compensation)

Table 15: Policy Tools deployed by the FSA

To facilitate the application of these tools, the FSA has organized the sector into five divisions and allocated each firm (of the 11,000 +) to one of five categories (deposit takers, market and exchanges, major financial groups, insurance firms and investment firms) (Paragraph 15). Each division is managed separately by the FSA, although within each

division the principles of allocating individual firms to risk categories on the basis of magnitude of impact and probability of risk are followed as a basis for assignment of regulatory resources.
(5) Endowment mortgages are insurance based investment schemes which aim to make the capital return to pay of the sum borrowed by the end of an agreed loan period accompanied by an interest only mortgage for the period of the mortgage. During the 1980s many consumers bought into endowment mortgages whereas the tradition in the British market had been to take on repayment mortgages. The basic problem was that re-projections of endowment policies indicated a widespread and significant short fall in the expected returns on these policies. Yet there was a widespread expectation amongst consumers that they would both cover the amount borrowed and gain a lump sum from the surplus at the end of the term.
(6) Specifically, firms were encouraged to send out re-projection letters to the 11 million holders of endowment policies informing them of the current performance of the investment part of the endowment together with an indication of the expected short fall at the end of the term. In addition, the FSA sent letters to policyholders explaining what they could expect from firms and outlining complaints procedures.
(7) Since the emergence of the endowment issue as a ‘crisis’ there has been much public discussion, debate and argument about responsibility to which the FSA has been a party. There have been many reports in the press, campaigns by NGOs (e.g. The Consumers' Association) and consumer complaints considered by the financial ombudsman.
(8) For example, were the projections based on up to date forecasts? Was there adequate review of the policy of selling endowments given the growth in the market? Was there adequate monitoring and management at the point of sale to check that the potential risks of the product were explained adequately to consumers? Was there a proper balance of the incentives given to advisors given the potential danger of miss-selling?
(9) On issues of disclosure, for example, it is possible that firms knew that their projections were optimistic for a long time before they informed customers of this possibility. This may have been compounded by there being no clear, sector wide rules for disclosure of product performance.
(10) It may be that products were sold using a language more appropriate to a savings scheme than an investment product, giving a misleading impression of the risks involved. Were consumers clearly advised that there was a risk that their endowments would not produce enough to cover the amount they had borrowed?
(11) It may be that consumers bought these products without being aware of the incentives for the seller/advisor, or the difference between independent and non-independent financial advice, or the schedule of charges associated with the product.
(12) In the spirit of his critique of narrow risk assessment, RENN (2000) gives a wide-ranging review of the factors entering the risk evaluation phase from an expansive risk assessment – including traditional measures, measures of uncertainty, the gap between cause and effect, ubiquity, persistence, potential for social mobilization and equity issues.
(13) It is a moot point whether advisors at the point of sale (the bridge between technical and user specification of risk characteristics) were aware of this gap between the narrow and the broad assessment of risk and whether they played along with or even fed the miscommunication over risk.

(14) Consider, for example, the FSA's task force on the use of past performance data in advertising, or its current working group on the development of risk indicators for financial service products. These working groups are composed of a variety of members from industry, consumer representative bodies and other interested parties (e.g. academic experts) and are given a brief to explore FSA policy in relation to a specific issue.
(15) The "Preparing for Emergencies" leaflets that were distributed to all households (Government, 2004) as part of a national campaign against terrorism is a good example of how use of the Precautionary Principle as a form of risk management has filtered into everyday life. Responses from the public were varied, ranging from "scaremongering" to "it's better to be safe than sorry". The way in which the government handled this operation is the key issue here, since they decided upon action rather than inaction in response to an indefinable threat.
(16) As noted earlier, the risk management approach adopted by FSA and Ofcom reflects a significant shift in risk literature (from dualist one-way communication to two-way communication in order to facilitate more dialogue). From the perspective of the regulators, what has been the driver for the emergence of citizen engagement? Is it in response to changing public views about governance and risks? Moreover, is it due to a growing understanding that existing forms of risk management (adhering to the notion of duality) cannot be sustained?
(17) Consumer Panels have been formulated to act in the interests of consumers, A key point for exploration is the activities of these Panels, and how they undertake their responsibilities to represent and protect the interests of consumers.
(18) According to GOUGH and HOOPER (2003) in public decision processes, the criteria for determining acceptability or tolerability of risks should incorporate considerations of public opinion or public perceptions of the risks in question. We are interested to explore whether/how the new regulators fulfil this notion.
(19) Effective risk communication is an intrinsic element of risk communication, and in determining acceptable levels of risk (risk assessment). Traditional understanding of risk communications is that organizations utilise "one-way" models of communication. In advocating effective forms of communication, theorists have advocated "two-way" models. Applications are typically science-centred, whereby it is posited that the inclusion of both expert and lay perspectives in decision-making processes should be the cornerstone of effective policy-making. Ofcom and FSA appear to be undertaking the "two-way" model of risk communication, adhering to a holistic form of risk management where potential risks are assessed with regard to broader stakeholders and consumers/citizens/public.
(20) The media are in some respects a "tool" for regulators, where they are seen in the public sphere "doing regulation". The media also play a role in the formation of public views about regulation. However regulatory speeches and reports are not transmitted to the public in a pure form, they undergo interpretation from media commentators. Traditional areas of risk research on the role of the media in shaping public awareness and opinions about risks may be relevant in some cases e.g. amplification/attenuation by the media. The media may also play a role in "availability bias" – risk events that can be recalled by members of the public. These issues of mediation of regulation also form an important dimension of our project.

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10. About the Contributors

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