

Interview: Outcomes Based Regulation

By CHRISTOPHER WOOLARD



Christopher Woollard

Q. *Chris, in both the Woollard Review, and one of your last major speeches as an executive at the FCA, you talked about “Outcomes Based Regulation.” (OBR) What do you mean by that?*

A. Thanks Stephen. There are two components to this. First, regulators often get locked into quite narrow views based on the tight legal construct of a product. To make regulation work well, we need to take a step back and look at how a product is sold and also how it is used by consumers. We should seek to give consumers protection and businesses certainty based on how the product operates in the real world.



A good example of this in the UK is home collected credit, which is a single loan from a compliance and legal

perspective but, in reality, it is used multiple times per year by many customers, much more like a credit card or overdraft line. Moreover, the business models of many firms in this market rely on this customer behaviour. I would argue it's far better to take a regulatory stance based on how the product is used than a narrow legalistic reading.

The second part, then, is to cut through the decades-old argument of “should you have principles-based regulation or rules-based?” For me, the right answer is you should have both. There are many situations

where, as a regulator, you want to set some broad parameters for how the market should be operating and the principles of competition and consumer protection. There are, however, times when you have to be very precise about expectations. A good example is UK forbearance rules that have operated as broad principles for many years, reflecting very different business models of some lenders, but during the Covid-19 emergency these were made much more prescriptive to achieve a consistency across all lenders.

Q. *In your latter example, what really drives the choice between rules and principles?*

A. As the name suggests, for me it is all about what outcome the regulator is seeking. That requires some deep thought. Often, the public or political clamour is for absolute protection from harm – which no system of law enforcement can ever guarantee – and, even if you could do so in regulated markets, it would imply the ‘stability of the grave’. In reality, regulating is often akin to refereeing a sports match – you want the game (in this case the market) to flow within some broadly accepted notions of behaviour and conduct. In the financial services case, this means we should see the emergence of new products and services focussed on changing consumer demands. But there will also be behaviours that are dangerous or harmful that need to be prevented, and we need to have clear penalties for transgression of those rules.

Q. *That sounds all terribly pragmatic – do you think that can really work?*

A. Yes, and I worry when policy makers get too entrenched in any one position. We can see examples where getting pinned too closely to a set of detailed rules drags regulation into narrow legal battles that ignore the bigger picture, for example, sometimes in the US. On the other side of the same coin, being too principles-based can be just as fraught, especially as emerging technologies mature and become more mainstream. Many regulators also have a range of

civil powers they can resort to, for example via action in the courts or general consumer law. In every case, regulators should be asking themselves what's the right outcome, and what's the right tool.

For a UK example, faced with the prospect of court action between insurers and their customers that would have dragged on for many years, and during which time many small businesses may have become bankrupt, the FCA took the novel step of intervening in the Business Interruption market so as to arrange for a fast-track process, through the courts, which would ensure certainty in the market. Inevitably, these kind of interventions will be rarely used, but form a powerful part of the regulator's toolkit.

Q. *Given the obvious importance of achieving desired outcomes, why is OBR not already the norm in regulation?*

A. That's a really good question. In part, outcomes are hard to define and success is hard to measure. For natural reasons, firms and policy makers often prefer hard and fast rules – for the regulated this offers the sense that “I complied with the rule, so I must be safe” while, for regulators, rules provide clear evidence that they are trying to manage a situation.

So, rules clearly have their part in this, and can be incredibly effective. But they need to be subordinate to the overall purpose the rules intend to serve. There is no point having 100% compliance if the outcome is not good or effective.

We can all think of different examples but, to give one, we know that despite huge resources deployed by regulators and firms, AML rules as a whole do a relatively poor job of helping detect and stop money laundering. (the UN estimates around 1% is stopped worldwide) There are emerging technologies that help do a much better job, especially when data is pooled among firms. But, in most countries, a system of checks by individual banks is mandated, rather than any co-operation among them.

Q. *Looking forward, how do you see an outcomes-based approach helping with the big global challenges that financial markets will face?*

A. I think there are three big global challenges: business after the pandemic; the rise of new technologies; and how financial services firms will play their part in the climate change agenda. All three of course are interlinked, overlap and are nuanced, but I'll try and illustrate each one quickly.

The cliché of the pandemic is that it has brought the future forward. Regulators around the world have learned to adjust their approach – for example, with regard to wholesale trades happening from home, or financial advice given and recorded remotely. In reality there is far more to come, especially as retail banks adjust to even more business being done online and we see less reliance on cash and the operation of their branch networks. This is really going to require governments, regulators and firms to work with society to develop a degree of consensus about what outcomes they want from the banking system.

And it's not just in greater amounts of business being done online where technology matters. As the Libra proposition exposed in 2019, virtual currencies and payment systems can reshape the landscape. Technology players will become more and more systemically important to parts of the financial system. Principles provide a useful guide to thinking about the consumer and societal outcomes that we want in this context, but there will need to be a level playing field between Big Tech and Big Finance, and the outcomes will almost certainly need underpinning with new rules that are fit for a digital age – and the removal of those that are not.

Last but not least, the whole ESG agenda is increasingly important, particularly with regard to how financial services firms play their part in the fight against climate change. At the moment much of the attention has been focussed on ethical investment, or stress-testing against global warming scenarios, but

meeting the Paris Accord targets will require most developed and developing economies to make huge investments in industry, housing and transport. There will need to be some very clear strategic thinking about how the financial sector – including insurers and long-term savings institutions – should support this agenda, and what will need to change in order to facilitate that.

There will be risks and multiple trade-offs that regulators, governments, firms and ultimately consumers will need to navigate and resolve. But by establishing clearly defined outcomes we aim for, and agreed principles by which they are to be achieved, we will enable the detailed rules that many firms will need in order to act with confidence.

Christopher Woolard is the former interim CEO of the UK's Financial Conduct Authority and was a member of the board and executive director for the past eight years. He was a member of the Bank of England's Financial Policy Committee and was the first chair of IOSCO's Fintech Network. He led the FCA's immediate response to the pandemic, including relief for mortgage and credit consumers, and the successful court action to settle business interruption insurance liabilities. His final role for the FCA was to chair the Review of Unsecured Credit (The Woolard Review) published in February before [insert next role when public]. At New Year 2021, he was awarded a CBE by HM the Queen for services to financial regulation and fintech. Subsequent to this interview, it was announced Chris had joined EY as a Partner and Chair of its Global Financial Services Regulatory Network. He will also become a non-executive trustee of Which?, the UK Consumers' Association.