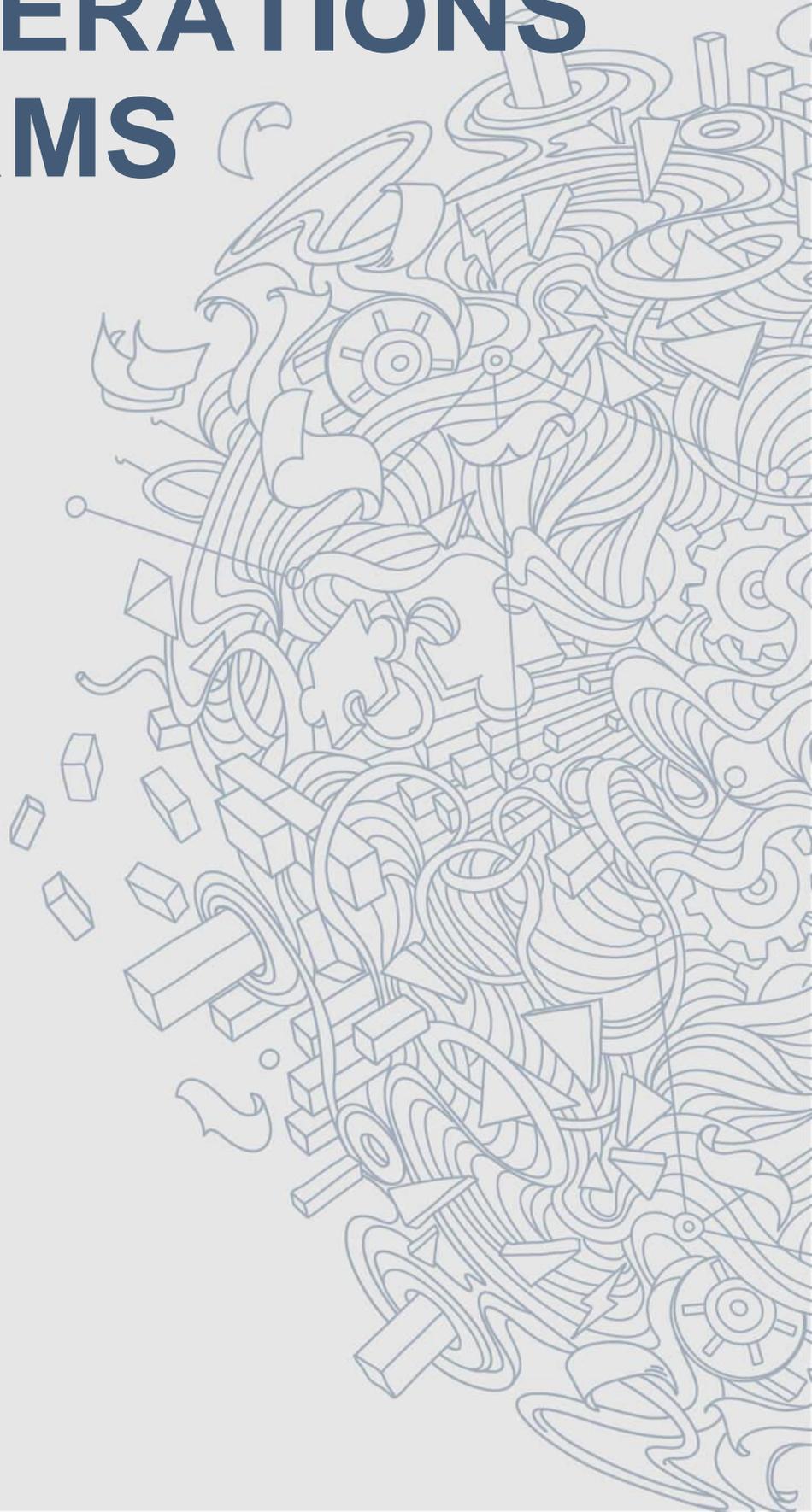


# FCA CONSUMER DUTY: EARLY CONSIDERATIONS FOR FIRMS

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# FCA CONSUMER DUTY: EARLY CONSIDERATIONS FOR FIRMS

THE FCA IS CONSULTING ON A PROPOSED NEW 'CONSUMER DUTY' WHICH, IF ADOPTED, IS LIKELY TO HAVE WIDE RANGING AND POTENTIALLY ONEROUS IMPLICATIONS FOR EVERY FIRM OPERATING IN RETAIL FINANCIAL SERVICES MARKETS.

The proposed Consumer Duty is designed to enhance existing conduct standards in retail markets, drive culture change and instil consumer trust. The FCA wants firms to put consumers at the heart of their business by proactively avoiding consumer harm at every level of their business and through every stage of the customer journey. It will place the onus on firms to abide by a new Principle for Business and to aim to deliver specific outcomes when designing, advising on or distributing products and services to retail clients. Importantly, all firms will be subject to rules specifically requiring them to take all reasonable steps to avoid causing foreseeable harm to consumers.

## WHAT IS THE FCA PROPOSING?

The FCA has issued [CP21/13: A New Consumer Duty](#), proposing a package of measures designed to operate together to enhance levels of consumer protection in retail financial services.

This is the next step in the FCA's work on potential policy approaches to introducing a duty of care in financial services, following its July 2018 [discussion paper](#) and its related [feedback statement](#) in 2019, which had set out industry feedback and the main arguments for and against introducing such a duty in statute.

The FCA is now proposing a Handbook-based approach to the introduction of a duty, meeting its obligation under section 29 of the new Financial Services Act 2021 to publicly consult on:

- whether it should make general rules providing that authorised persons owe a duty of care to consumers;
- the level of care that must be provided to consumers by authorised persons; and
- whether such duty should be owed to all consumers or to particular classes of consumer.

Section 29 obliges the FCA to publish its analysis of the responses to this consultation by the end of 2021 and make final rules before 1 August 2022.

The FCA proposes that the new Consumer Duty will require firms to ask themselves what outcomes consumers should be able to expect from their products and services. Firms will need to act to enable rather than hinder these outcomes and will have an ongoing obligation to assess the effectiveness of their actions.

The Consumer Duty will comprise the package of components set out below.

FCA CONSUMER DUTY	
<b>Consumer Principle</b>	An overarching principle which sets out the overall standards of behaviour the FCA wants from firms.  Options for the wording: 'A firm must act to deliver good outcomes for retail clients' or 'A firm must act in the best interests of retail clients'
<b>Cross-cutting rules</b>	These rules will develop the FCA's overarching expectations for common themes that apply across all areas of firm conduct.  Firms must take <b>all reasonable steps</b> to: <ul style="list-style-type: none"><li>• avoid causing foreseeable harm</li><li>• enable customers to pursue their financial objectives</li></ul> Firms must <b>act in good faith</b> toward customers.
<b>Specific Outcomes</b>	Specific outcomes for key elements of the firm-consumer relationship:

## FCA CONSUMER DUTY

- 1 **Communications** equip consumers to make effective, timely and properly informed decisions about financial products and services.
- 2 **Products and Services** are specifically designed to meet the needs of consumers, and sold to those whose needs they meet.
- 3 **Customer Service** meets the needs of consumers, enabling them to realise the benefits of products and services and act in their interests without undue hindrance.
- 4 The price of products and services represents **fair value for consumers**.

### Private Right of Action for breach of FCA Principles

The FCA is also considering whether a private right of action should be introduced for breaches of the Principles for Businesses, to provide a right for consumers to seek damages for loss caused by the breach. If introduced, this would be analogous to the private right of action for breaches of FCA rules and by extension would also enable the FCA to use its powers under section 404 of FSMA to impose an industry-wide redress scheme where there are breaches of the Consumer Duty or other Principles.

FCA plans to host a webinar on the new Consumer Duty package on 10 June 2021 and consultation feedback is invited by 31 July 2021. A further consultation is planned later in the year.

## WHAT FIRMS, CUSTOMERS, PRODUCTS AND SERVICES WILL FALL WITHIN THE DUTY?

The FCA intends to apply the Consumer Duty to FCA regulated firms providing products or services to existing and potential retail clients, as defined in the FCA Handbook. This includes any firm involved in the product or service distribution chain that has no direct relationship with the end-consumer where it can "*through its regulated activities, influence material aspects of design, target market or performance of a product or service that will be used by consumers*". The duty will also apply to E-money institutions, Payment Institutions and Registered Account Information Service Providers.

The FCA defines 'retail client' as including SMEs, customers of firms conducting credit related regulated activities and persons receiving advice on stakeholder pensions. Professional and wholesale customers would remain subject to existing Principles and rules, including for example the detailed requirements in PROD relating to product governance.

Firms should be alert to the fact that the intent of the proposed Consumer Duty to raise standards in retail markets means that Handbook provisions that placed more stringent requirements on firms for some products may in future capture a wider range of products. For example, firms manufacturing and distributing products such as shares, derivatives, bonds, insurance products etc are already subject to stringent product design, approval and monitoring obligations under the EU-derived rules in the FCA's Product Governance sourcebook (PROD). Firms not within the scope of PROD have only to date been required to follow guidance (in the FCA's regulatory guide on the Responsibilities of Providers and Distributors for the Fair Treatment of Customers (RPPD)), but the Consumer duty is likely to apply rules similar (but not identical) to PROD to other firms and products, for example consumer credit.

There will not, in the FCA's view, be retrospective application to past business once the Consumer Duty is in effect. The FCA also states: "*Nor do we intend to judge practices with the benefit of hindsight.*" (para 2.37).

## HOW WILL THE DUTY INTERACT WITH THE EXISTING FRAMEWORK?

At this stage, the final shape of the Consumer Duty and its components is some way off. The FCA is seeking feedback from firms on how the Consumer Principle might be worded, its proposals for the four outcomes and its high level proposals for the scope and structure of the rules. There is also no indication of how much time firms will be given to comply with the new package.

The FCA's position is that the new Consumer Principle would introduce a higher standard on firms than its existing Principles for Businesses and conduct rules and would "*indicate to firms that they need to play a greater and more positive role in delivering*

*good outcomes for consumers – including those who are not direct customers of the firm*" (para 3.10). It will sit with the FCA's existing Principles within the PRIN sourcebook. In a departure from its previous approach, the FCA also intends to place the rules and guidance that support the Consumer Principle alongside it in PRIN, rather than elsewhere in the Handbook.

It is a given that regulatory standards with which firms must comply when dealing with retail clients need to be articulated as clearly and unambiguously as possible. The key question – both for firms' compliance and in terms of future supervision - is the extent to which the Consumer Principle would overlap with, supersede or otherwise impact on existing Principles. The FCA's view is that, where firms are complying with the Consumer Principle, they will in general also be complying with Principles 6 (Treating Customers Fairly) and 7 (Communications with customers). As such, it is consulting on whether or not a clearer approach would be to disapply those Principles for firms that are expected to comply with the Consumer Principle.

Another key issue is what form and scope the new proposed cross-cutting rules will have. The FCA will use the next consultation to consult on the detail of the cross-cutting rules to support the Consumer Principle and the four outcomes. The FCA's stated intention is that the new rules will complement rather than replace existing rules. For example, in relation to communications, the Consumer Duty will not replace the communications-related provisions in other existing consumer protection legislation such as the Consumer Rights Act 2015, the Enterprise Act 2002 and the Consumer Protection from Unfair Trading Regulations 2008.

We set out further below where we believe careful work will be required, should these proposals proceed, to ensure that the regulatory system is coherent and comprehensible to those bound by it.

## KEY AREAS OF CONCERN

### 1. ENGAGING WITH THIS CONSULTATION

Aspects of changes that the FCA is proposing are controversial, and the proposals if implemented in their current form are potentially radical in their effect. We encourage firms to consider the potential impact on them and in particular what unintended consequences the proposals might create. Firms should consider the window of opportunity to make their views known, either by engagement with their trade bodies or by directly responding to the consultation by the 31 July 2021 deadline. This opportunity for engagement could also include making suggestions to the FCA on how the Handbook could be clarified by the removal or consolidation of existing rules.

### 2. BRINGING NEW PRODUCTS TO MARKET AND AMENDING PRODUCTS

As mentioned above, the FCA intends to extend "PROD-like" rules to all other firms not currently caught by PROD rules. While the FCA has not yet made clear how granular these rules are likely to be (its aim is to apply the 'general concepts' of PROD more widely and in a proportionate way) the proposals will mean that, potentially, firms that have previously complied to an extent with the guidance in RPPD will find themselves in a position of being newly subject to binding obligations to identify their target markets, to enhance their product approval process, carry out risk assessments, scenario testing and product monitoring to ensure ongoing compatibility of both the product and its distribution strategy with the target market.

Requirements for ongoing regular and event-driven product reviews may involve firms needing to refresh, retool or refocus products or services that were previously compliant with Principle 6.

As with PROD rules, the allocation of responsibilities along what is sometimes a long and complex product distribution chain will be left largely to the contractual arrangements between firms in the chain.

### 3. FAIR VALUE

As with product governance, the FCA's proposals set out its intention to take more stringent policy that it has applied in one part of the sector and expand that to all firms in retail markets. In the case of fair value, this means building on its recent policy in the general insurance and funeral plans sector.

The proposed 'Price and Value' outcome firms would need to achieve is that the benefits consumers receive from products or services are *reasonable relative to the price they pay*. This would allow differential pricing so long as it is reasonable. The FCA's view is that, where firms are routinely required to give greater consideration to price and the role it plays in the fair value of products and services this will reduce the need for FCA to make interventions such as price caps or other price interventions such as those in the rent-to-own and overdrafts markets.

The concern with this proposed outcome is that, despite the FCA's emphatic statements that it does not intend to engage in price regulation (see para 4.108), in practical terms there is a risk that FCA will have the opportunity to intervene greatly in firms' pricing models on the grounds of reasonableness, as well as make market-wide interventions where it considers that poor value

persists. Equally, while the FCA is keen to stress that it has no intention of preventing firms profiting from high operating margins for innovative products and services, there will surely come a point at which the FCA would recommend firms consider reducing their operating margins for such innovations so that the benefits can be passed on consumers. This could very well harm competition depending on the FCA's appetite to interfere.

#### **4. DEMONSTRABILITY**

The FCA's intention behind the proposed consumer outcomes is that they would push firms towards making their own informed evaluation of the potential consumer impact of their commercial decisions. This would limit the scope for firms to take comfort from avoiding breaches of specific rules while engaging in activities that directly or indirectly profit the firm but not necessarily the consumer (for example, push tactics such as making unsolicited increases on credit card limits, or sludge practices that hamper exit from products).

The FCA would require a great deal more information from firms so that it is sufficiently 'data-led' going forward to be able to intervene quickly before harmful practices become entrenched 'market norms'.

For example, firms will need to:

- demonstrate to the FCA how they have performed the fair value assessment for products and services;
- explain why they think their pricing model is reasonable;
- demonstrate how they have reviewed and adapted their communications with consumers to align with the proposed outcomes;
- provide information to the FCA to evidence outcomes from their product monitoring and testing activity; and
- continually self-assess so that they can justify the appropriateness of their business models and their treatment of their customers.

As the proposals stand, taken together the new information requirements are likely to be burdensome. It will be interesting to see how the FCA measures the impact of these increased obligations in the Cost Benefit Analysis that will be included in the second consultation.

#### **5. THE WIDER CONTEXT**

There is a real risk of firms being overwhelmed by multi-stranded changes to the regulatory regime. We consider that the FCA needs to think carefully about the cumulative impact for firms of the potentially challenging requirements of the Consumer Duty in context with HM Treasury's Future Regulatory Framework review (FRF Review).

HM Treasury has been consulting via the FRF Review on a proposed move away from detailed EU-era regulatory standards which have by necessity been onshored in the UK statute book for Brexit. We believe that unless these proposals from FCA are harmonised with the output of that wider review, and the two are implemented in a consistent way, there is a risk of the regulatory system becoming even less cohesive and even more complex and unwieldy for firms than it already is. All with consequential enforcement risk for firms. This is compounded by the fact that the FRF Review itself must be considered in context with a number of wide ranging sector specific initiatives including climate change, adjustments to prudential requirements, UK Listing Regime reform, the Payments Landscape Review, the outcomes from the Kalifa Review and initiatives promoting the UK's international brand, such as the UK's Overseas Framework and enhancements to the UK's funds regime.

We believe clarification and rationalisation of existing materials would be essential, as well as effective signposting. We believe the FCA should also make clear in the second consultation how the new Consumer Principle and the other Principles would interact with the output from activity-specific regulatory principles envisaged by the FRF Review, not least to allay concerns that further 'outcomes' may in future be attached to existing Principles as a consequence of new activity-specific regimes.

#### **6. CHANGE MANAGEMENT**

Firms would need to give thought to how the new duties need to be translated into their day to day businesses. While we must wait for the second consultation for the precise drafting of the Consumer Principle and the new supporting rules and guidance, firms can review the outcomes and the harms they are designed to prevent, and work to identify any possible changes that might be needed.

This might include considering the systems, procedures and processes that may need to be changed for customer service provision or complaints handling or where product or service adaptations are needed to ensure the firm can demonstrate reasonable best efforts to avoid harm. Documentary changes might also be needed, for example to customer disclosure

documentation such as terms and conditions, product descriptions that present charging information, website disclosures or financial promotions.

Firms would also need to scrutinise their business model. The Consumer Duty's emphasis on harm prevention means that business models must have consumer interests at their heart. Some firms might need to make changes to ensure improved product and service design and regular re-evaluation of customers' needs across the consumer journey. The good faith element of the duty means the FCA would be highly unlikely to tolerate business models that are designed to profit from customers' vulnerability, lack of financial savvy, behavioural bias or constrained ability to make choices.

The Consumer Duty would require senior management to think proactively about the FCA's intent behind the duty and the impact of all of the firm's actions on the needs and objectives of end-consumers. The duty includes a 'lessons learned' element and an obligation to rectify issues arising for example from product monitoring through the life cycle. Senior management would be responsible for deciding on the level of 'reasonable best efforts' the firm must make to avoid consumer harm and for assessing what proactive steps their firms should take to address ineffective elements of their organisational culture.

Where the firm forms part of a product distribution chain, the incoming "PROD-like" obligations mean its senior management would need carefully to consider the extent to which the Consumer Duty will attach to the firm's activities.

## 7. ENFORCEMENT AND LITIGATION RISKS

Criticisms have been levelled at the FCA for being too slow and too tentative in its readiness to tackle emerging issues even where it has early notice (for example via whistle-blowers), too often adopting a piecemeal, product-by-product approach to firms' harmful practices, and then only after lengthy reviews and consultations. As a result, strong arguments were put forward during the development of both the Financial Guidance and Claims Act 2018 and the Financial Services Act 2021 that there is a need for an overarching duty of care to consumers and that this should be embedded in statute. The Treasury Select Committee has also supported a statutory duty should the FCA's rulebook and principles be inadequate.

In opting for a Handbook-based approach, the FCA intends that the Consumer Duty form a core part of its transformation programme, which includes the use of outcomes to assess firms' practices and conduct. The Consumer Duty would enable the FCA to be more flexible and agile, taking action in cases of new and emerging harms that may not be captured by existing rules.

On the face of it, this appears a very positive step. However, the renewed focus on outcomes seems more than a little reminiscent of the approach taken by the FSA following the global financial crisis of 2008, in which it moved towards an outcomes-focused but enforcement-led regime, taking action which was later criticised not just by firms but also by government. Whilst it may be hoped that a renewed focus on outcomes will help the sector benefit from fewer market wide interventions and remediation obligations, principles-based intervention and enforcement carries with it its own serious challenges for firms.

We believe serious consideration needs to be given to the interaction of the Consumer Principle with Principles 6 and 7. It is not just a technical point. It reveals the magnitude of the change which FCA is proposing. After over 15 years of FSA/FCA supervision and enforcement activity based on the concept of treating customers fairly, backed by Principle 6, the core regulatory standard would be changing materially with widespread consequences for firms that are newly subject to the Consumer Principle.

FCA notes in the consultation paper that a key challenge to disapplying Principles 6 and 7 where the Consumer Principle applies would be the volume of existing regulatory material based on those principles, but comments that it "*does not propose to revisit*" that material immediately should the new proposals be adopted. Rationalising past material would no doubt be an enormous regulatory task, but equally not doing so could leave scope for widespread confusion about regulatory standards (and attendant enforcement risk for firms), particularly in the wider context of the FRF Review outcomes. Firms and consumers alike (as well as the FOS) would need to be aware that existing regulatory guidance may no longer be indicative of the standards to which firms must adhere if these proposals proceed.

It appears to us that the FCA's proposals leave unanswered a number of key questions, which will require detailed further consideration, in particular how the Consumer Principle would impact the construction of existing detailed regulatory rules and other provisions. The FCA comments, for example, that "*the Consumer Duty would be compatible with, but would not replace, existing Handbook material (such as PROD) that sets specific requirements for the manufacture and/or distribution of products and services*" (para 4.49). However, where an overarching principle or duty is available to FCA as a basis for enforcement, there must be some risk for a firm that its compliance with detailed rules in the form they appear in the Handbook or legislation would in practice be found insufficient. For example, what if the FCA took the view that the firm had indeed complied with Handbook rules, but simply needed to do more to "deliver good outcomes for retail clients". How would a firm know in advance (for example, when taking a new product to market) whether or not it is meeting the required regulatory standard?

## CONCLUSION

The prospect of a form of customer duty or consumer principle has been in discussion for a number of years and it is welcome that we are now beginning to see the shape of what that framework will look like and the focus of the FCA to ensure that firms in the FCA's words "get it right in the first place". As the FCA recognises in the paper, the duty will require a significant shift in culture and behaviours for certain firms which may be both costly and time/resource intensive to implement at a time when the sector is expected to continue to play an important role in supporting consumers and businesses in their recovery from the impact of the pandemic. There is a risk that, absent more clarity from the FCA, trying to achieve 'good outcomes' could increase banks' risk-aversion and ultimately restrict products to some customers. Introduction of a private right of action could also increase risk aversion, which may impact the FCA's competition agenda. Ultimately it is important to bear in mind that the proposed package has a wide potential reach, covering all customer facing FS firms, and non-customer facing firms whose products are used by consumers.



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