

Consumer Duty briefing

1. Overview

On 14 May 2021 the FCA published its first Consultation Paper on a new “Consumer Duty” (CP21/13).¹ The new Consumer Duty would:

- apply to regulated firms, including electronic money institutions and payment institutions; and
- require them to meet a higher standard of care in relation to their regulated services for ‘retail clients’, who include both consumers and small and medium-sized enterprises (SMEs).

The FCA has indicated that this could require significant changes to the culture and behaviour of many firms. At its core the Consumer Duty would require firms to ask themselves: ‘would I recommend my firm’s products and services to my friends and family?’ Firms may therefore need to comprehensively reassess their policies, processes and documentation for retail customers as against the Consumer Duty.

This consultation closes on 31 July 2021, with a second consultation on the Consumer Duty (including draft rules and guidance) to follow by 31 December 2021. The FCA expects to make any new rules by 31 July 2022. We describe the consultation proposals below, and also briefly touch on a separate, but related, proposal to introduce a new private right of action for breaches of FCA principles.

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¹ Available at <https://www.fca.org.uk/publications/consultation-papers/cp21-13-new-consumer-duty>. CP 21/13 follows the FCA’s Discussion Paper 18/05 on ‘A duty of care and potential alternative approaches’ and its Feedback Statement 19/02.

2. Key points

The new Consumer Duty would require firms to ask what outcomes retail clients should be able to expect from their products and services and take action to enable, rather than hinder, these outcomes. It would apply to all levels of a firm's activities – from strategic planning all the way down to individual customer interactions.

To achieve this the FCA are proposing that the Consumer Duty has three elements:

1. Consumer Principle. This broad "Consumer Principle" would provide an overarching standard of conduct that firms have to meet when producing or distributing products and services to retail clients (please see section 5 below for more details).

2. Cross-Cutting Rules. To assist firms in implementing the Consumer Principle the FCA is proposing a set of "Cross-Cutting Rules" which would apply across all areas of firm conduct (please see section 6).

3. The Four Outcomes. These proposed "Outcomes" are a suite of rules and guidance that offer firms greater detail as to how to implement the Consumer Principle into their working practices. The Four Outcomes deal with communications, products and services, customer service, and price and value (please see section 7).

3. Scope

The new Consumer Duty would apply to all firms, including electronic money institutions and payment institutions, in relation to their regulated activities that relate to products and services sold to retail clients. 'Retail clients' is a broad class which includes all clients who are not professional clients and eligible counterparties. The term therefore includes SMEs, where the provision of financial services to such SMEs is regulated.

The FCA also emphasised in CP21/13 that their proposals extend to firms that are involved in the manufacture or supply of products and services to retail clients, even where those firms do not have a direct relationship with the retail client.

4. Aim of the Consumer Duty

The FCA wants to see a higher level of protection in retail financial markets. The Consumer Duty would add to the range of regulatory tools the FCA already uses to ensure that markets work well. The Consultation Paper suggests that the FCA are particularly concerned that some firms are:

1. presenting retail clients with inadequate or misleading information about products and services;
2. providing products and services which are either not fit for purpose or that do not represent a fair value for the retail client; and
3. providing inadequate customer service or other practices which hinder the retail client's ability to act, or which exploit information asymmetries, consumer inertia, behavioural biases or vulnerabilities.

By implementing the new Consumer Duty the FCA is hoping to prevent these harms for retail clients. As CP21/13 emphasises:

"In short, we want firms to act in good faith, to avoid causing harm, to empower consumers by placing them in a position where they are able to make effective decisions, so that consumers can take responsibility for their actions and decisions" (CP 21/13, paragraph 2.25).

It is worth noting that in the Consultation Paper, the FCA talks about the introduction of the Consumer Duty as creating a "...paradigm shift in our [the FCA's] expectation of firms in retail markets" (CP 21/13, paragraph 2.36e).

This suggests that it would be prudent for firms to reassess their policies, processes and documentation for retail customers, with a view to updating them as needed to implement the Consumer Duty.

5. Consumer Principle

The Consumer Principle will be a high-level statement of the expectations placed on firms to ensure good consumer outcomes. This principle will reflect the overall standard that the FCA is expecting of firms. The FCA is proposing that the Principle is set to a higher standard than the existing requirement under Principle 6 that a firm “pay due regard to the interests of its customers and treat them fairly”.

6. Cross-Cutting Rules

The Cross-Cutting Rules would develop the FCA’s overarching expectations for common themes, which apply across all areas of firm conduct and which would be included in the FCA Handbook. The proposed Cross-Cutting Rules consist of the following three key elements.

- **Firms must take all reasonable steps to avoid foreseeable harm to retail clients.** This would require a proactive approach from firms and would require firms to think about possible harms that could arise from their conduct, products and services.

7. The Four Outcomes

The FCA is proposing to set out their expectations for firms in a suite of rules and guidance, which are expected to appear in the second Consultation Paper on this topic, due by the end of this year. These rules and guidance will be arranged under the Four Outcomes: communication, products and services, customer service, and price and value.

CP 21/13 gives a **narrative overview** of what the FCA expects the Four Outcomes’ suite of rules and guidance to cover, as follows:

7.1 Communications

Under this Outcome, firms would be expected to consistently support retail clients by giving them adequate information to make informed financial decisions. This information must be given to retail clients at the right time and be presented in a way that is understandable.

The FCA has proposed two formulae of the Principle:

Option 1: ‘A firm must act to deliver good outcomes for retail clients’

Option 2: ‘A firm must act in the best interests of retail clients’

The FCA is seeking feedback on the formulation of the Principle.

- **Firms must take all reasonable steps to enable retail clients to pursue their financial objectives.** This would require firms to create an environment in which retail clients are able to act in their own best interests. While retail clients would remain ultimately responsible for their decisions, firms would be required, for example, to think about retail clients’ potential vulnerabilities or behavioural biases that could prevent them from making informed financial decisions and take action to temper these.
- **Firms must act in good faith.** Firms would be expected to act honestly, fairly and openly. Their actions would have to be consistent with the reasonable expectations of retail clients.

The FCA has been concerned about the communication practices of some firms in the retail market. These practices include ‘hiding’ key information in large volumes of material, giving retail clients insufficient information about products or services, and communications not being tailored to the channel used.

The FCA is proposing to draft rules and guidance under which firms may be required, at all points in a product’s lifecycle, to:

- review their customer communications and make sure they are understandable and enable customers to take appropriate action;
- tailor their customer communications to the customer’s characteristics and the nature of the product or service;
- tailor their customer communications to the channel of communication used; and
- test their communications to see whether they are meeting the required standard.

7.2 Products and services

Under this Outcome, firms would be expected to ensure that their products and services are designed to specifically meet the needs of retail clients.

These rules will extend to both the distributors and manufacturers of products and services. Where different, product distributors and product manufacturers would be expected to work in tandem to ensure that the requirements under this Outcome are met.

The FCA is proposing to draft rules and guidance under which firms may be required to:

- specify a ‘target market’ for the product, and establish whether this target market includes vulnerable customers;
- take reasonable steps in the distribution of their product to make sure that the product is marketed to the target market rather than to other consumers;
- ensure that their products and services fulfil the consumers’ reasonable expectations as to cost, benefits and performance; and
- perform ongoing monitoring of their products and services to ensure these requirements continue to be met.

7.3 Customer service

Under this Outcome, the FCA is proposing to introduce rules and guidance that aim to ensure that firms meet the needs of their customers throughout their relationships with them.

The FCA is proposing to draft rules and guidance under which firms may be required to:

- design processes that take retail client needs and the needs of the target market of any product into account. These processes must ensure that no undue financial or time costs are imposed on retail clients;
- monitor the performance of their processes for evidence that they are not meeting the needs of retail clients; and
- take responsibility for ensuring the same level of customer service is provided when customer services are outsourced to third parties.

7.4 Price and value

Under this Outcome, the FCA is proposing to introduce rules and guidance that aim to ensure that the prices of products and services represent fair value for retail clients. Fair value of a product or service is to be measured against the expected benefit of the product or service. The FCA emphasises in CP21/13 that the proposed rules under this Outcome are not intended to remove price flexibility.

The FCA is proposing to draft rules and guidance under which firms may be required to:

- proactively consider the benefits that retail clients will be expecting from their products and services and use this as a benchmark against which to price their products and services;
- consider all costs and charges a retail client may incur when setting a price-point for a product or service;
- consider whether their pricing practices represent fair value for different consumer groups, including groups that share protected characteristics as defined under the Equality Act 2010; and
- provide evidence to the FCA that the price assessment processes required under the Consumer Duty have been conducted appropriately.



8. Private right of action

The FCA is also consulting on introducing a new private right of action (**PROA**) for breaches of the FCA Principles, including the new Consumer Principle. The PROA would give individuals a right of action for damages caused by a breach of an FCA Principle.

The FCA is seeking input from stakeholders on the possible benefits or unintended consequences of introducing a PROA for breach of the Consumer Principle.

9. What next?

The FCA is seeking feedback on their proposals by 31 July 2021. The second Consultation Paper on the new Consumer Duty, which will include the consultation on the draft rules and guidance, the FCA's cost benefit analysis of the proposals and further consideration of the PROA, is expected by 31 December 2021. The FCA expects to make any new rules by 31 July 2022.