

Podcast 7 – A new Consumer Duty

Joanne Owens, Victoria Ferres, Sophie Skeet and Mercy Hadfield

Joanne: Welcome to the latest episode in the Allen & Overy podcast series “In Credit”. My name is Joanne Owens and I’m counsel in Allen & Overy’s financial services regulatory group. I’m joined by senior associate Victoria Ferres [“Hello”] and also by associate Sophie Skeet [“Hello”] and trainee solicitor Mercy Hadfield [“Hello”].

In this episode, we are going to be focusing on the FCA’s recent proposals to introduce a new ‘Consumer Duty’, as set out in its consultation paper of 14 May. I find this topic personally really interesting and some of the changes are quite significant. So let’s dive straight in.

The basic principle is that the FCA wants to see a higher level of consumer protection in retail financial markets. So in essence the new Consumer Duty would require firms to provide a higher standard of care for consumers and the FCA has indicated that the proposed measures could be a ‘paradigm shift’ for how many firms do business in the consumer financial services sector. The FCA has also stated in the consultation paper that this new Consumer Duty is not intended to give rise to a fiduciary duty.

Victoria: Many of us will appreciate that this is not completely out of the blue. This consultation paper follows on from the FCA’s 2018 discussion paper on a proposed duty of care, as well as the subsequent feedback statement that came out in 2019. Also, the content of the consultation paper echoes many of the key themes that we’ve seen the FCA emphasise recently – so, for example, the consultation paper repeatedly picks up on the issue of how firms should be treating vulnerable customers, which is a topic that has been around for a long time.

Joanne: Yes, and we actually discussed this on our podcast back in April in the context of the FCA’s guidance released on vulnerability.

Victoria: We did!

Sophie: However, while the goals and themes in the proposed Consumer Duty will be very familiar, many of the measures that may come out of this consultation will actually be quite new to firms. The FCA says that the Consumer Duty, at its core, is about requiring firms to ask themselves: “Would I be happy to be treated in the way my firm treats its customers?” or even “Would I recommend my firm’s products and services to my friends and family?”

Mercy: Those sound like quite big questions! If these themes have been around for a while and the FCA has been considering introducing a new duty as far back as 2018, are there any particular drivers as to why the FCA is looking at this again in 2021?

Joanne: This topic has been on the table for quite some time. Victoria has already mentioned the discussion paper in 2018 and at that time the focus was on both whether a duty should be implemented but also the fundamental nature of that duty. More recently, the Financial Services Act 2021 actually imposed an obligation on the FCA to carry out a public consultation to determine if new rules are required. No one will doubt the need to ensure that consumers are

treated fairly, and the FCA's more recent work has indicated a growing concern around potential consumer harm.

Sophie: A significant contributing factor will be the evidence the FCA has seen of poor customer outcomes. The consultation paper talked a lot about so-called 'sludge practices'. This is where firms make it very difficult for customers, whether knowingly or not, to perform simple actions, such as switching providers, getting information about alternative services and cancelling their products. The new Consumer Duty is aiming to create firm environments where customers are empowered to take control of their financial lives and make good decisions for themselves.

Mercy: Exactly. And to do this the FCA are proposing that the Duty should have three elements:

- **Firstly, the Consumer Principle.** This broad principle would provide an overarching standard of conduct that firms have to meet when producing or distributing products and services to retail clients.
- **Secondly, the 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.
- **And thirdly, the Four Outcomes.** These proposed Outcomes are a suite of rules and guidance which 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. This is definitely the meatiest part of the new Duty.

Joanne: So Victoria, who would the new Consumer Duty apply to?

Victoria: The proposal is that the new Duty would apply to all firms – including electronic money institutions and payment institutions – in relation to their regulated activities which relate to products and services sold to retail clients. 'Retail clients' is a very broad class which includes all clients who are not professional clients. This therefore includes SME clients. Interestingly, the FCA have flagged that these proposals would extend to firms that are involved in the manufacture or supply of products and services to retail clients, even where that firm does not have a direct relationship with the retail customer.

Sophie: Wow, so a very broad scope too! But what about the content of the proposals? I was interested to read about the proposed Consumer Principle, but I wasn't sure how it was different from the existing FCA Principles.

Joanne: There is definitely some overlap. We of course have the concept of 'treating customers fairly' or 'TCF' under Principle 6 of the FCA's Principles for Business, but the FCA is proposing that the Principle we're talking about here is set to a higher standard than the existing requirement under Principle 6. The Consumer Principle will effectively be a high-level statement of the expectation on firms to ensure good consumer outcomes.

Victoria: But where it gets really interesting is in the proposed cross-cutting rules and the Four Outcomes rules guidance. The cross-cutting rules will revolve around three key elements: They will require that

- *Firms must take all reasonable steps to avoid foreseeable harm to customers.*
- *Firms must also take all reasonable steps to enable customers to pursue their financial objectives, and that*

– *Firms must act in good faith.*

Mercy: What about some more specific rules for firms? Did we get any indication about what they might look like?

Joanne: Well, the FCA has suggested that they will release a suite of rules and guidance arranged around their Four Outcomes, namely (1) Communication, (2) Products and services, (3) Customer service, and (4) Price and value.

The consultation paper only gives a narrative overview of what the FCA expects these to cover. The text of the draft Handbook rules and guidance are expected to appear in the second consultation paper on this topic, due by the end of this year – so watch this space! But Victoria, did we learn anything interesting from the consultation paper about what firms can expect from these rules?

Victoria: Oh absolutely. Let's look at communication first. Under this Outcome, firms would be expected to consistently support consumers by giving them adequate information to make informed financial decisions. This information must be given to consumers at the right time and be presented in a way that is understandable.

Some examples of what firms may be required to do under this Outcome include reviewing their customer communications and making sure they are understandable and enable customers to take appropriate action. For example, where appropriate, customers should be able to easily find information on how to cancel a product or service.

Mercy: In addition, firms may also need to tailor their communications to a customer's characteristics and the nature of the product or service. For example, when dealing with vulnerable customers, extra information, or information that is presented differently may be required. Information on products and services that have a wide potential user base, such as personal current accounts with no overdraft facility, should not contain the same level of detail as information on complex products, such as personal pension plans.

Sophie: I thought it was also interesting how the consultation paper suggested that communications may also need to be tailored to the channel of communication used. The FCA has emphasised, for example, that consumers may be less likely to read long-form information when purchasing a product or service on a mobile device. As such, firms may be required to adapt the information they give on mobile devices to make sure that the meaningful information is appropriately flagged to the customer. And these standards are expected to be met at every point in the product lifecycle.

Joanne: We see similar themes under the second Outcome too, for 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 consumers. Firms would be expected to identify the target market of their product and ensure the design of their product meets the requirements of that target market. Firms would also need to 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.

Victoria: And what if one firm designs the product and then a different firm distributes it?

Joanne: Well, product distributors and product manufacturers would be expected to work in tandem to ensure that all of the requirements under this Outcome are met.

- Mercy:** Very interesting! Sophie, would you be able to give us an overview of what might be required under the third Outcome, customer service?
- Sophie:** Of course. 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 relationship with them. The goal here is that consumers should be able to engage confidently with their products and services, both before and after purchase. More concretely, firms may be expected to design processes that take consumer needs and the needs of the target market of any product into account. Firms must not have processes that impose undue financial or time costs on consumers when consumers attempt to act in their own interest, especially at what the FCA calls 'friction points'. These are the points in the consumer-provider relationship where things get a bit more tricky, such as when customers are trying to switch provider or cancel a contract.
- Mercy:** So this is to tackle the 'sludge practices' we talked about earlier – firms will have to make sure their practices don't make life especially harder for their customers.
- Victoria:** Yes, and to make sure that these processes are working, firms would be expected to monitor the performance of their processes for evidence that they are not meeting consumer needs. This would involve a regular review of all processes where firms will be expected to use evidence about customer habits to aid them, for example by looking at the percentage of calls that get abandoned when customers call their help line. If the percentage is too high, firms may have to, for example, increase capacity at their call centres. And firms would also be expected to take responsibility for ensuring the same level of customer service is provided when customer services are outsourced to third parties.
- Sophie:** What about the fourth Outcome – price and value? How are firms supposed to measure what represents 'fair value'?
- Joanne:** Well, 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 the consumer.
- Effectively the fair value of a product or service is to be measured against the product or service's expected benefit. Firms would be required to proactively consider the benefit that consumers will be expecting from their products and services and to use this as a benchmark against which to price their product or service. This would involve a consideration of both the financial benefit of the product as well as the non-financial benefits – for example, a service which offers enhanced customer support may be justified in having a higher price point.
- Victoria:** I thought it was especially interesting that the consultation paper raised the point that when establishing a price for a product or service, firms would need to consider all costs and charges that a customer may incur, including non-financial costs, such as time costs and the privacy cost of products and services that involve customers relinquishing extensive personal data.
- Mercy:** Yes, exactly, this outcome isn't just about financial value. For example, firms would also need to 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.
- I think it is also worth mentioning that the FCA is also consulting on introducing a new private right of action for breaches of the FCA Principles, including the new Consumer Principle. This would give individuals a right of action for damages caused by a breach of an FCA Principle. That could be another big difference for firms and consumers alike.

Joanne: It sounds like there’s lots of possible changes on the horizon!

Sophie: Absolutely. This consultation is open for responses until the end of July this year and we’ll know more about the substance of the rules and guidance when we get the second consultation paper, which we expect to see by the end of this year.

Joanne: It’ll be exciting to see the draft rules as it seems that there is plenty to talk about, and of course we will cover them on “In Credit”! Well, sadly that brings us to the end of this episode. Thanks for listening and please do get in touch with any thoughts or comments, or indeed requests for future podcasts!



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