Podcast – A new Consumer Duty
What should e-money and payments firms do?

Nikki Johnstone, Jamie Greenwood, Claire Haydon

Nikki Johnstone

Hello and welcome to this Allen & Overy podcast on the new FCA consumer duty. My name is Nikki Johnstone and I'm a partner in the London Regulatory and Fintech practices. I'm joined today by Jamie Greenwood, a senior associate in the London Regulatory and Fintech practice and also by Claire Haydon from A&O Consulting. And we're here today to discuss the key legal and practical implications of the latest FCA Proposals for consumer duty. We're going to focus today on the impacts for payments and e money firms and what they should be doing to prepare for the April 2023 deadline.

So Jamie, let's start with the basics. Can you tell us what the consumer duty is?

Jamie Greenwood

Sure Nikki. The consumer duty has been under consideration by the FCA for quite some time now and the latest consultation was published in December last year. The basic premise is that the FCA wants to see a higher level of consumer protection in retail financial markets.

The duty itself comprises three elements. The consumer principle, the three cross cutting rules and the four outcomes. The consumer principle which will become a new FCA Principle 12, will replace Principles 6 and 7 for retail business. This new principle requires firms to act to deliver good outcomes for retail customers and is intended to underpin and drive culture and conduct changes within regulated firms. To give meaning to this high level principle it needs to be interpreted by reference to cross-cutting rules and outcomes that make up the other elements of the consumer duty. The cross-cutting rules develop the FCA's overarching expectations for key elements of the consumer/firm relationship. They set out how to deliver good customer outcomes and require firms to act in good faith towards customers, avoid causing foreseeable harm and enable and support customers to pursue their financial objectives. As the FCA makes clear, the effect of the consumer principle and these rules, isn't to create a fiduciary relationship where one doesn't already exist, or to impose an open ended duty that goes beyond the scope of the firm's ability to determine or influence consumer outcomes or protect customers from all potential harms.

The third element of the consumer duty – the four outcomes – offer firms guidance on how to implement the consumer principle into their working practices in four areas: the governance of products and services, pricing value, consumer understanding, and consumer support. The consumer duty is going to be underpinned by a concept of reasonableness. This means that the proposed rules and guidance should all be interpreted in line with the standard that could reasonably be expected of a prudent firm when carrying on the activity in relation to the same product or service and with the necessary understanding of the needs and characteristics of its customers. Since the standard reflects the tortious concept of how a reasonably prudent firm would act, the FCA views it as one firms are already familiar with due to their existing duties under common law.

Nikki Johnstone

Thanks Jamie. I mean it sounds like the FCA is really trying to reset expectations of firms operating in the retail markets so it's a lot to think about for PIs and EMIs who provide their services to consumers or quasi consumers. It may be worth quickly breaking down who exactly the consumer duty package is going to apply to.

Jamie Greenwood Yeah. The new regime is going to apply to all firms including those in the temporary permissions regime in relation to their regulated and ancillary activities which relate to products and services for prospective and existing retail customers.

The FCA has resisted providing a single definition of retail customer for the purposes of the consumer duty but it's clarified that the definition should align with the applicable rules for each regulated retail sector. So, for EMIs and PIs, this means that the consumer duty will apply to business conducted with not just consumers but micro-enterprises and charities as well. This aligns with the approach taken in the payment services regulations which has additional protections for all consumer and quasi consumer customers. To the extent that PIs and EMIs provide other regulated products where they're under a separate FCA authorisation or in partnership with a third party, it's worth noting that the definition of retail customer for those products may be different. Firms should also remember that even where the consumer duty doesn't apply, Principles 6 and 7 may still be relevant. When thinking about its retail customers, PIs and EMIs should make sure they consider prospective as well as existing customers in their consumer duty planning. The measures will apply, not just in day to day customer interactions but also when marketing to prospective customers and issuing financial promotions.

Nikki Johnstone Interesting. So does this mean that I, as a PI or EMI, only have to worry about implementing the consumer duty for my future business or do I have to look at my existing products?

Jamie Greenwood I'm afraid you have to think about both. Whilst the consumer duty doesn't have a retrospective effect, it applies on a forward looking basis to existing products and services whether or not they're still being sold to new customers. The FCA expects firms to review its existing products and services before the end of the implementation period and all aspects of the consumer duty including the products and services outcomes and the pricing value outcome. This might mean a PI or EMI needs to update the contractual terms and conditions of a product or service before it can be sold to new customers.

Nikki Johnstone Great. Thanks Jamie. Turning now to Claire, we've talked about scoping so now we need to think about what a good product outcome might be for retail customers in the payments and e money sector. What should firms be thinking about?

Claire Haydon Well, there's quite a lot for firms to think about here. So as Jamie's explained, the four outcomes really cover key elements of the relationship between a firm and its customers so that is how firms design, sell and service their products and services and the key contact points along the customer journey. So, it's obviously not new that the FCA expects firms to have good product governance in place and effective systems and controls to monitor whether the products that they are selling are meeting customer needs but there are now some more explicit requirements. So, there's a lot of focus on identifying the target market and understanding that market's needs, characteristics and objectives. Unsurprisingly, given the FCA's focus on vulnerable customers over the past few years, this should include an assessment of whether the target market might include vulnerable customers and what that means in terms of the design and operation of those products and services. Now, of interest to PIs and EMIs, there has been a lot of discussion around the price and value outcome which requires that the price of products and services represents fair value for consumers. This has understandably prompted a huge amount of debate across the industry about what fair value is. EMIs and PIs have pointed out that customers already have full transparency over fees but the FCA has indicated that while clearly communicating pricing structures helps, firms should not rely solely on individual customers' willingness to buy the product or serve as evidence of fair value and have been very clear that value is about more than just price. The FCA has suggested at least four additional considerations that might be relevant here including non financial benefits and costs as well as cognitive and behavioural biases.

Nikki Johnstone Okay. So maybe delving further into the other outcomes now, could you provide some examples of good product outcomes?

Claire Haydon Yes. So, looking first at consumer understanding, the FCA is really trying to emphasise that this is not just about providing or passing on required information, it's about making sure your target market is able to understand what is being provided to them and the FCA has said explicitly that this is about building on and going further than the existing Principle 7. So, what's interesting to note from the draft FCA guidance here is that it's not just about communication and engagements specifically around products and services but really about all communication through all channels, even when that's not specific to a particular product. There's a high expectation set in terms of testing required to ensure that communications are likely to be understood by the average retail customer and an expectation that there is consideration of the information needs of those recipients so there are some interesting conversations to be had around testing and monitoring standards. Then, finally we have consumer support which emphasises the need to support consumers throughout the whole life-cycle. This is about making sure that consumers can use products as expected so that they're able to realise the benefits and make sure that there are not unreasonable barriers in place. So, it's not just about designing an excellent Fintech product or service, it's about making those products and service and their benefits accessible to consumers. Again, there's a very high standard of monitoring expected here and an expectation that firms are looking at the experience of consumers across the life-cycle and using information to monitor that and make changes on a real time basis where required.

Nikki Johnstone Interesting, thanks Claire. This seems like it will involve a lot of research and data gathering for firms. Is this something that you'd expect the board or senior management to have on their agenda?

Claire Haydon Absolutely. So all four outcomes have some very stringent monitoring, testing and oversight requirements aligned to them and there's a clear statement from the FCA that firms should have all necessary information available to understand and monitor consumer outcomes. So it's really important that firms are reflecting on their existing suite of management information, reporting data and metrics as well as the quality of outcome testing and the breadth of oversight on all aspects of these four outcomes as well as the governance that is in place to oversee what's happening in practice. There's been a lot of focus in terms of governance and the expectation that there's an annual sign-off from the board about whether the firm is delivering these four outcomes under the consumer duty. But, this is not just about the board exercising the right level of oversight. In order to make sure the board has a comprehensive report on new and emerging risks and has the results of monitoring and how many poor outcomes identified have been addressed, there is a lot that needs to be undertaken throughout the firm on a day to day basis to have the evidence base that the FCA expects.

Nikki Johnstone Great, thanks Claire. So turning back now to you Jamie, we know that senior management will be required to oversee and expected to oversee ongoing work to address the consumer duty. Is there anything else that we need to know about how directors or managers or PIs and EMIs might be accountable for this?

Jamie Greenwood The consumer duty proposal looks to make some upgrades to the FCA senior managers and certification or SMCR regime. In particular, with the addition of a new individual conduct rule to act to deliver good outcomes for retail customers. This will be accompanied by obligations that reflect the cross-cutting rules I introduced earlier. The SMCR doesn't yet apply to EMIs and PIs but the FCA has previously announced in its perimeter report that it intends to extend this regime to cover e money and payments firms. This means that in addition to planning for how your governance procedures need to be adapted to prepare for the implementation of SMCR, firms will need to ensure that one or more of their senior managers have overall responsibility for overseeing the steps that they're taking to implement the requirements in relation to the consumer duty.

Nikki Johnstone	Well, it sounds like SMCR is going to be worth another podcast so maybe we'll stay with the consumer duty and in particular, what PIs and EMIs should do next. Jamie, Claire, what are y our top tips?
Jamie Greenwood	Well, I think the biggest challenge will be identifying those products that are within scope by reference to the rules that apply. Secondly, you'll need to identify the framework contracts applicable to each of your in scope products. When you've identified these in scope products you'll need to determine whether or not there are any harms that might result from breaches of the cross-cutting rules. Depending on your product book, this could be quite a detailed and careful scoping exercise but once you've completed it, you can begin to assess the in scope items against the new standards that we've been discussing today and align your product strategy and governance framework with that.
Nikki Johnstone	And Claire, what about you?
Claire Haydon	So, I've got a few more tips to add. Firstly, I suggest you involve your product teams and revisit the product design and approval framework. Really make sure that this can evidence the decisions that you're taking as a firm and the outcomes that customers are receiving. Secondly, think about analysing all the data sources that you have and identify any new data sources required within your firm to ensure there's appropriate coverage of all relevant products and services. You should be able to measure against defined criteria developed for demonstrating adherence to the consumer principle and these cross-cutting rules. You should also really look to examine the skills and capabilities that you have within your firm. So put simply, do your first line business, the second line risk and compliance teams, the audit teams have the skillset and the capabilities needed to reach judgements on consumer outcomes including things like identifying cognitive biases? So you might then need to have a think about how any gaps can be filled, whether that's training or bringing new resource in. Finally, as we've talked about, you really need to engage with your board. So firstly, making sure they're aware of this new requirement and regulatory expectations and then making sure that there's early engagement with the board in terms of understanding what the regulators are looking for from them and the impact of that on the business, given that the board will be required to confirm that a firm's business strategy is consistent with meeting consumer duty requirements. This engagement with the board will effectively shape what the annual reporting which requires their sign-off will look like. So, firms should start thinking now about that reporting and make sure the board is comfortable with what comes next.
Nikki Johnstone	Great. Thank you both. We should of course keep an eye out for any further changes that the FCA might make in the final rules and guidance which we're expecting to be published at the end of July this year. The FCA has then set quite a tight deadline for implementation with implementation required by the end of April 2023. But, thank you for listening and as always, please do get in touch if you'd like to know more or if you have any comments or feedback.

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