



# THE FCA CONSUMER DUTY BREAKING NEW GROUND

Sarah Hitchins, Bob Penn, Zoë Jensen and Paul Edwards of Allen & Overy LLP and Tom Anderson of A&O Consulting explain the new requirements that firms will need to follow to comply with the new FCA consumer duty, as well as their practical impact.

The Financial Conduct Authority (FCA) has finalised its new proposed consumer duty, which will start to come into force from July 2023, and has published accompanying guidance ([www.fca.org.uk/publication/policy/ps22-9.pdf](http://www.fca.org.uk/publication/policy/ps22-9.pdf); [www.fca.org.uk/publication/finalised-guidance/fg22-5.pdf](http://www.fca.org.uk/publication/finalised-guidance/fg22-5.pdf)). The FCA has described the consumer duty as an initiative that will lead to a major shift in financial services and one that will break new ground to ensure that all firms take account of the actual impact of their services and product suitability on the consumer. This article examines the new requirements that firms will need to follow to comply with the consumer duty, as well as their practical impact.

## SCOPE

Subject to certain exclusions from the definition of “retail market business”, the consumer duty will apply to all UK regulated

firms that offer products and services to retail consumers, including in situations where there is a distribution chain that involves retail consumers (*see News brief “FCA fleshes out the new consumer duty: meaty changes ahead”, [www.practicallaw.com/w-034-1997](http://www.practicallaw.com/w-034-1997)*).

As a result, the consumer duty may cover firms that do not interact, or have direct relationships, with retail customers if they materially influence retail customer outcomes. This includes firms that play a role in creating, developing, designing, issuing, operating, underwriting or making arrangements in relation to products for retail customers, or firms that materially influence communications that are issued to retail consumers or have direct contact with retail consumers on behalf of another firm.

Firms that have direct relationships with retail consumers have the greatest responsibility

under the consumer duty, and firms that outsource activities to third parties retain ultimate responsibility for meeting the requirements and standards of the consumer duty.

In addition to covering new products, the consumer duty will apply to existing and closed products. It will also apply to potential and actual customers of in-scope firms. However, the consumer duty will not apply to unregulated business, such as unregulated buy-to-let lending or commercial lending.

From a territorial perspective, the consumer duty will apply generally with respect to activities carried out with retail customers located in the UK unless another applicable rule or onshored regulation that is relevant to the activity has a different territorial scope, in which case new Principle 12 of the FCA’s Principles for Businesses (Principle 12)

and new chapter PRIN 2A “The Consumer Duty” of the FCA’s Principles for Business sourcebook (PRIN) apply with that scope in relation to the activity described in that rule or onshored legislation (PRIN 3.3.1R).

The territorial application rule in PRIN 3.3.1R is somewhat obscure, not least as multiple rules and regulations with different territorial scopes may apply to any given activity. However, it is most likely that the FCA intends for the consumer duty to co-exist with its existing conduct of business obligations that apply to each class of regulated business to which it applies.

### WHAT IS THE NEW DUTY?

There are three key components to the new consumer duty: a new consumer principle, three cross-cutting rules and four outcomes (see box “Underpinning of reasonableness”).

#### New consumer principle

The FCA has introduced a new consumer principle which reflects the overall standard of conduct that it requires of firms and which is defined further by the other elements of the consumer duty. This requirement takes the form of Principle 12 and states that a firm must act to deliver good outcomes for retail customers (see box “Moving beyond treating customers fairly”).

#### Cross-cutting rules

The FCA has introduced new cross-cutting rules that are designed to set out the FCA’s expectations for firms’ conduct through three overarching requirements. These cross-cutting rules explain how firms should act to deliver good outcomes for retail customers and are also intended to help firms to interpret the four outcomes (see below).

**Good faith.** Firms are required to act in good faith towards retail customers. This rule focuses on the intention behind a firm’s actions and it will be used to assess whether firms’ conduct adheres to the standards of honesty, fairness and open dealing that is consistent with the reasonable expectations of retail consumers. This makes it a broad concept that will need to be interpreted in different ways not only by different firms but also within firms to cater for the different types of consumers that they deal with.

**Avoid harm.** Firms are required to avoid causing foreseeable harm to retail customers at all stages of the consumer journey. This

### Underpinning of reasonableness

Despite the requirements set by the consumer duty, the Financial Conduct Authority (FCA) recognises that consumers should take responsibility for their own financial decisions. As a result, firms are not expected to protect consumers from risks that they have understood and accepted. That said, firms must ensure that consumers have the information and support that they need in order to make informed decisions.

When assessing firms’ compliance with the consumer duty, the FCA will judge firms by the standard that could be reasonably expected of a prudent firm that is carrying on the same activity in relation to the same product, taking into account the needs and characteristics of consumers in the relevant target market.

includes firms identifying potential harm if a customer is considering changing products, and will require firms to collect and maintain sufficient information in order to ensure that they can act in a way which avoids foreseeable harm. Although foreseeability has a specific meaning in both contract law and tort, it remains to be seen how the FCA will interpret foreseeability in this context and, in particular, whether it will decide to take a wider ranging interpretation when determining what harm may be foreseeable in the context of the consumer duty.

**Customer objectives.** Firms must enable and support retail customers to pursue their financial objectives. Firms will be required to consider this rule throughout the consumer journey, including in relation to product design, consumer communications and customer support. The actions that are required of firms under this rule will be determined by reference to what is within a firm’s control, based on the role and knowledge of consumers.

Importantly, these cross-cutting rules will come into force as formal FCA rules. As a result, and unlike the significant volume of informal guidance and industry expectations that the FCA’s predecessor, the Financial Services Authority, articulated in relation to its Treating Customers Fairly initiative, these cross-cutting rules are capable of being breached. It will, therefore, be possible for the FCA to take enforcement action against a firm not only for failing to comply with the new high-level obligation in Principle 12 but also for breaching any of these specific cross-cutting rules (see “FCA expectations” below).

#### Outcomes

The four outcomes introduced by the FCA are a suite of rules and guidance setting out more detailed expectations for firm conduct

in four areas that represent key elements of the firm-consumer relationship.

**Product and service governance.** The outcome regarding the governance of products and services will require firms to ensure that the design of a product meets the needs, characteristics and objectives of consumers in the identified target market for that product and that the distribution strategy for the product is appropriate for the target market. Firms will need to monitor and regularly review these areas.

**Price and value.** The FCA considers that a product provides fair value to consumers where the amount paid for the product in question is reasonable relative to the benefits of the product. An assessment of fair value in this context should assess the benefits that a customer can reasonably expect, the product’s quality and any limitations. For packaged products, this assessment will apply to each component of the product as well as the package as a whole.

As part of this assessment, firms should also consider non-financial costs, such as permission to use a customer’s personal data, and non-financial benefits, such as enhanced levels of customer service. A product that provides negligible or no obvious benefit to consumers will not be considered to provide fair value to consumers, even if it is provided for free.

**Consumer understanding.** The FCA expects firms to communicate with consumers in a way that is likely to be understood by retail consumers and that equips them to make effective, timely and properly informed decisions. As a result, firms will need to ensure that the consumer communications that they design or use are tailored to the type of communication, the complexity of

the product, the characteristics of the target market and the role of the firm in relation to the product in question.

**Consumer support.** The FCA requires firms to ensure that they provide an appropriate standard of support to retail consumers, so that it:

- Meets the needs of retail consumers, including those who are considered to be vulnerable.
- Ensures that retail consumers can use the product as reasonably anticipated.
- Ensures that retail consumers do not face unreasonable barriers, for example, when complaining, claiming under a product, switching or exiting a product.

Firms should not prioritise new consumers over existing consumers.

### Wholesale firms

The FCA has been keen to emphasise that the consumer duty will not only apply to retail firms. For wholesale firms, it is expected that the consumer duty is likely to be largely relevant to structured product business where the products are ultimately sold to retail clients. The FCA has previously called out poor practice in the market for structured products and there is expected to be significant regulatory focus on these types of products, given their relative complexity and the difficulty that retail customers may have in understanding the products.

The consumer duty will affect both distributors and manufacturers of these products. However, the FCA has been at pains to stress that the impact of the consumer duty on wholesale business should be limited. In its feedback to the consultation on the consumer duty (the feedback), the FCA emphasised that obligations on firms must be interpreted proportionately, in a manner that reflects the firm's role in the distribution chain and its ability to influence retail customer outcomes ([www.fca.org.uk/publication/policy/ps22-9.pdf](http://www.fca.org.uk/publication/policy/ps22-9.pdf)). It has also given helpful guidance in the feedback around the relationship between manufacturers and distributors, emphasising that firms are not responsible for the compliance of others and that firms should merely take reasonable steps where distributors with which they deal do not provide information to them.

## Moving beyond treating customers fairly

It is over 16 years since the Financial Services Authority, as it then was, introduced its Treating Customers Fairly (TCF) initiative. Similar to the consumer duty, the TCF initiative focused on customer outcomes. In particular, it introduced six improved outcomes for retail consumers for firms to achieve and make an integral part of their business culture.

The consumer duty is not replacing TCF. Principle 6 of the Financial Conduct Authority's (FCA) Principles for Businesses, which requires a firm to pay due regard to the interests of its customers and treat them fairly, and FCA Individual Conduct Rule 4, which requires relevant individuals to pay due regard to the interests of customers and treat them fairly, will continue to apply in situations where the consumer duty does not apply. As a result, firms and their employees will need to assess continually whether TCF or the consumer duty applies to a specific situation, and act accordingly.

### FCA EXPECTATIONS

Through its consultation papers and policy statement about the consumer duty, the FCA has made clear its expectations of firms in relation to the consumer duty. In particular, the FCA has stated that firms should:

- Put consumers at the heart of their business and focus on delivering good outcomes for customers.
- Provide products and services that are designed to meet customers' needs, provide fair value, help customers achieve their financial objectives and do not cause them harm.
- Communicate and engage with customers so that they can make effective, timely and properly informed decisions about financial products and services, and can take responsibility for their actions and decisions.
- Not seek to exploit customers' behavioural biases, lack of knowledge or characteristics of vulnerability.
- Support their customers in realising the benefits of the products and services that they buy and acting in their interests without unreasonable barriers.
- Consistently consider the needs of their customers, and how they behave, at every stage of the product or service lifecycle.
- Continuously learn from their growing focus and awareness of real customer outcomes.

- Ensure that the interests of their customers are central to their culture and purpose, and are embedded throughout the organisation.
- Monitor and regularly review the outcomes that their customers are experiencing in practice and take action to address any risks to good customer outcomes.

### INDIVIDUAL ACCOUNTABILITY

In addition to the new rules that will apply to firms, the FCA's suite of requirements relating to the consumer duty will also impose new obligations on firms' employees.

#### All employees

The biggest change for employees personally will be the introduction of a new individual conduct rule 6 into the FCA's Code of Conduct sourcebook (COCON) that will require employees to act to deliver good outcomes for retail customers. This new rule will only apply in circumstances where the consumer duty applies. It will serve as an objective standard against which employees will be assessed, although the nature and extent of the regulatory expectations of an employee under this new individual conduct rule will depend on the nature and scope of their role, as well as their seniority and experience.

#### Boards and senior managers

The FCA has made it clear that firms' boards must take full responsibility for ensuring that the consumer duty is embedded within their businesses. It has also made clear that senior managers are accountable for the outcomes that their firms' customers are experiencing, in accordance with their obligations under

## Key dates and milestones

31 October 2022

The deadline for a firm's board to have agreed plans to implement the consumer duty. By that date, boards should have been able to evidence that they have scrutinised and challenged the plans to ensure that they are deliverable and robust to meet the new standards. Firms should expect to be asked to share implementation plans, board papers and minutes with supervisors, and be challenged on their contents.

30 April 2023

The deadline for relevant manufacturers to share key information with relevant distributors.

31 July 2023

The consumer duty will begin to apply to firms in respect of all new products and services, and all existing products and services that remain on sale or open for renewal.

31 July 2024

The consumer duty will begin to apply to all closed products and services. The intention is to give firms more time to bring these older products, which are no longer on sale, up to the new standards.

31 July 2024

The deadline for a firm's first annual report on complying with the consumer duty. This relates to the new requirement for a firm to conduct an internal assessment at least annually (see "Boards and senior managers" in the main text).

### Ongoing obligations

The Financial Conduct Authority (FCA) has imposed the following express requirements, which are unusual and reinforce the degree of importance being placed by the FCA on this regulatory initiative:

- Boards must maintain oversight of a firm's implementation plans to ensure that they remain on track, and that their work to review and improve the firm's products and services is sufficient to comply with the new regime.
- Firms are required to notify the FCA if their implementation project is not on track.
- At the end of the implementation period, boards should ensure that their firms are compliant, and that any potential gaps or weaknesses, and any action needed to remediate these, have been identified.

the FCA's senior managers and certification regime (see Briefing "Senior managers and certification regime: another year on", [www.practicallaw.com/w-013-8923](http://www.practicallaw.com/w-013-8923)).

However, the obligations of senior management under the consumer duty will not stop when their firms have implemented the consumer duty.

The consumer duty will introduce an annual requirement for a firm's board to review and approve an assessment as to whether the firm is delivering good outcomes for its customers. This annual assessment will need to include:

- The results of ongoing monitoring about the firm's compliance with the consumer duty.
- New and emerging risks that are affecting or may affect the firm's abilities to deliver good outcomes for consumers.
- Any evidence identified of poor consumer outcomes, the impact of these outcomes

and their root causes, as well as what actions the firm has taken to address these issues.

- How the firm's future business strategy is consistent with acting to deliver good outcomes under the consumer duty.

The FCA has also stated that each firm should have a "champion" at board level, ideally an independent non-executive director, who, along with the firm's chair and CEO, ensures that the consumer duty is discussed regularly and raised in all relevant discussions.

### Senior managers' reporting obligations

FCA senior manager conduct rule 4 requires senior managers to disclose appropriately any information of which the FCA or the Prudential Regulatory Authority would reasonably expect notice. The FCA has supplemented its guidance in COCON 4.2 (the senior manager guidance) about the meaning of this requirement to cater for the consumer duty. In particular, the FCA

has made it expressly clear that if a firm is obliged to notify the FCA that another firm, such as a distributor, is not or may not be complying with the consumer duty, the senior manager with responsibility for the business area in question should ensure that the firm reports this information to the FCA.

If the matter is outside the remit of a senior manager's responsibilities and they are unable to assume that their firm has made this kind of report to the FCA, the senior manager is expected proactively to check whether such a report has, in fact, been made to the FCA.

By introducing the senior manager guidance, the authors do not consider that the FCA intends for firms or senior managers to assume responsibility for the risks that are associated with other firms' activities. Rather, the FCA is emphasising to senior managers that if they become aware of an actual or potential issue involving another firm which may amount to non-compliance with the

consumer duty, they are expected to ensure that this information is reported to the FCA, instead of turning a blind eye to it.

## NO PRIVATE RIGHT OF ACTION

When the FCA was consulting on its proposals for the new consumer duty, it considered including a private right of action. This would have enabled consumers to bring civil claims against firms for breaching the consumer duty.

However, the FCA has decided not to introduce a private right of action in relation to the consumer duty. The FCA acknowledged that this is a polarising issue but, at least for now, has decided that its existing framework is likely to be a more appropriate route for almost all consumers to seek redress and pursue complaints without legal representation and at no additional cost to them. The FCA's complaints rules already require firms to investigate complaints competently, diligently and impartially, and the consumer duty will strengthen the requirements on firms to support customers with complaints, particularly under the consumer support outcome (see "Outcomes" above).

The FCA has left open the possibility of it introducing a private right of action in the future, stating that it will keep the matter under review.

## FINANCIAL OMBUDSMAN SERVICE

During the consultation, many stakeholders expressed concerns about how the Financial Ombudsman Service (FOS) will interpret the consumer duty. In particular, these concerns focused on whether the FOS may adopt a different or wider interpretation of the consumer duty than the FCA as the FOS is required to consider what is fair and reasonable in any specific circumstance and is not bound to follow applicable law or regulation.

The FCA has tried to reassure firms that it will work closely with the FOS with the aim of ensuring a consistent view on the interpretation of the consumer duty. However, it remains to be seen how effective this co-ordination will be in practice, especially as the FOS is entirely separate and independent from the FCA and the FCA has no formal power to influence decisions taken by the FOS. As a result, the authors expect that

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there is a risk of firms needing to reconcile FOS decisions that are inconsistent with the FCA's interpretation of the consumer duty, at least initially and perhaps even on an ongoing basis.

## ENFORCEMENT RISKS

The consumer duty will bring with it new and increased enforcement risks for firms and their employees. At present, the FCA is focusing on how firms and their senior management are approaching and progressing the task of implementing its requirements relating to the consumer duty (see feature article "FCA and PRA enforcement actions: trends and predictions", [www.practicallaw.com/w-034-1498](https://www.practicallaw.com/w-034-1498)). As July 2023 approaches, this focus is only likely to intensify.

Once the consumer duty starts to come into force from 31 July 2023, it is anticipated that the FCA will closely scrutinise how firms and their senior management have implemented the consumer duty and, importantly,

whether firms and their employees are, in fact, delivering good outcomes to retail consumers in situations where the consumer duty applies.

In terms of what this scrutiny will look like, the FCA has stated that it intends to undertake thematic or multi-firm work after the consumer duty comes into force in 2023 to see how it is operating in practice. These exercises often result in supervisory action being taken, or referrals being made to the FCA's enforcement division where the FCA identifies significant shortcomings. At least initially, the FCA is likely to focus its enforcement attention on specific examples of especially poor compliance.

It is unlikely that the FCA will start any formal enforcement investigations into firms or individuals who are suspected of breaches of the consumer duty until late 2023 or early 2024 at the earliest. However, in the meantime, firms will need to consider whether they have complied with the consumer duty in the context of internal

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investigations into issues that may arise. For example, where firms identify instances of suspected employee misconduct, they will need to consider proactively whether those employees have complied with the FCA's new individual conduct rule 6, which requires them to act to deliver good outcomes for retail customers, and to report breaches to the FCA (see "All employees" above).

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## NEXT STEPS

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It is clear that firms' work in relation to the consumer duty will not be over once they have completed their implementation programmes. The FCA will require firms to

monitor the outcomes that retail consumers receive with a particular focus on:

- Identifying and monitoring risks to achieving good outcomes for retail consumers.
- Identifying poor outcomes and undertaking root cause analysis in order to identify the reasons for those poor outcomes.
- Having processes in place to change products and services, as and when required, in order to ensure that they contribute to achieving good outcomes for retail consumers.

- Identifying whether certain groups of customers, for example, customers with specific characteristics or vulnerable customers, have received worse or "less good" outcomes than other customers.

As a result, even as firms pass the milestones to implementation, their work in relation to the consumer duty will be far from over (see box "Key dates and milestones").

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