Consumer Duty Phase II
December 2021

Summary

In its new Consumer Duty proposals, the Financial Conduct Authority (FCA) wants to ensure a higher and more consistent standard of consumer protection for users of financial services and to help stop harm before it happens. It wants to secure a 'paradigm shift' towards more 'outcomes-focussed regulation.'

In its response to the first Consumer Duty consultation, the BVRLA said that consumers were already adequately protected by the principles and rules contained within the existing regulatory framework and that the FCA could achieve its desired outcomes through more rigorous supervision or enforcement. The FCA does not agree and believes a new Consumer Principle is required as customers are currently finding it hard to make informed choices on the right products and services for them at the right price, especially due to new harms emerging in increasingly digital markets.

This second consultation confirms that the FCA is proposing to add a new 12th Consumer Principle to its existing FCA Principles for Business - *A firm must act to deliver good outcomes for retail customers* – which will be supported by a set of three high-level rules and four outcomes that provide more certainty on what 'good' looks like.

Key elements for BVRLA members are the two outcomes focussed on 'Price and Value' and 'Consumer Understanding'. The FCA has less experience and track record of regulating in the area of pricing and fair value which could lead to it having to conduct more thematic reviews and provide more guidance on commissions and other forms of remuneration. The wording 'Consumer Understanding' reflects the fact that the FCA doesn't just want communications to be received, it wants them to be understood. The regulator acknowledges the clear communication constraints imposed by the Consumer Credit Act and is talking to Treasury about how this can be addressed.

The proposed Duty has a very broad scope. In it, the FCA has opted for a definition of 'retail client' that includes SMEs and aligns with the scope of the Handbook in each sector. Consumer protection laws are well defined, but the motor finance industry may have to interpret or seek further guidance on what these mean for the broader category of retail clients. The FCA has also proposed that some of the new rules will apply to firms that don't have a direct contractual relationship with the customer but are still involved with the manufacture or delivery of products and services to retail clients.

The latest consultation emphasises that firms will be required to monitor, report and evidence their compliance with the Duty, demonstrating that their business models, actions and culture are focused on delivering good consumer outcomes at every stage of a product or service's regulated Lifecyle. The firm's board will be responsible for ensuring these outcomes are consistent with the standards of the Consumer Duty, supported by its interaction with the SM&CR.

New governance and reporting frameworks will undoubtedly need be developed and firms will need to assess whether the nine-month implementation period being proposed (new rules published on 31st July 2022 and take effect from 30th April 2023).

Document prepared by Policy and Public Affairs Advisor, Eleanor Bruce

Member input required

The FCA is seeking responses on the details of the Consumer Duty proposals. In light of this additional information in the latest consultation, please provide the BVRLA with input on the following issues:

- What do you think about the intention to apply the Consumer Duty to firms' dealings with retail clients as defined in the FCA Handbook? In the context of regulated activities, are there any other consumers to whom the Duty should or should not relate?
- What do you think about the intention to apply the Consumer Duty to all firms engaging in regulated activities across the retail distribution chain, including where they do not have a direct customer relationship with the 'end user' of their product or service?
- What do you think of the proposed new Consumer Principle and the disapplication of Principles 6 and 7 where Principle 12 applies?
- What do you think of the proposed cross-cutting rules?
- What do you think of the proposed requirements under the products and services, price and value, consumer understanding and consumer support outcomes? For example, is there a conflict between the requirement for clearer communications and the prescribed disclosure stipulations contained within Consumer Credit legislation?
- Do the draft rules and related non-Handbook guidance provide enough detail and examples for firms?
- Do the draft rules and related non-Handbook guidance do enough to ensure firms consider the diverse needs of customers, including those with vulnerability and protected characteristics
- Are there any specific case studies or examples that would provide useful guidance on implementing the new Duty?
- What do you think of the proposed implementation timetable (by 30th April 2023)?

A full list of questions can be found in the consultation paper under Useful Links. Please contact Eleanor Bruce at Eleanor@bvrla.co.uk to provide feedback on the above.

Scope of the new Duty

The first consultation proposed that the Duty would apply to all *retail customers*, including those of SMEs. This measure would be disproportionate if applied as the Consumer Duty consists of a Principle and rules, yet some SMEs only fall into the scope of Principles and not the Handbook rules. The FCA therefore proposes to align the scope with the existing sectoral Sourcebooks, meaning that SMEs whose clients are defined as retail customers in that sector will be subject to the Consumer Duty. Principles 6 and 7 will continue to apply where they did previously to the retail clients of SMEs that are outside the scope of the sectoral rules (and thus the Consumer Duty). The new proposed scope therefore applies to *the regulated activities and ancillary activities of all authorised firms in respect of both products and services for their prospective and actual retail customers*. This definition includes any firm engaging in regulated activities with any person who is, or potentially would be, the end retail customer in the distribution chain (whether or not they are a direct client of the firm). Firms that do have a direct customer relationship with the 'end user' will have the greatest responsibility under the Consumer Duty, as their risk of causing direct harm is greater. In general, firms are responsible only for their own activities rather than the actions of other firms in the distribution chain – however, where firms outsource activities to third parties, they remain responsible for compliance and must consider whether outsourcing could result in a negative impact for customers. Firms must also have regard to the wider distribution strategy when designing a product or service to ensure distribution to the right target market at fair value is monitored over time.

How the Duty will be applied

The Consumer Duty will apply on a forward-looking basis, not retrospectively, to existing products or services which are still being sold or renewed after the duty comes into effect. Firms must therefore review the contractual terms and conditions of a product or service during implementation. This applies to existing contracts on closed products which will not be marketed or distributed after the Duty comes into force, meaning firms should assess whether the product could be leading to harms.

Where a firm is planning to alter or withdraw a product or service, they should consider whether it could harm customers and take steps to mitigate this, such as not withdrawing the product or service too abruptly and ensuring that they communicate any changes in a timely, clear and sensitive manner.

How the new Duty will be structured

The Consumer Duty is comprised of a new Principle, three cross-cutting rules and four outcomes. The Principle reflects the overall behaviour expected from firms, whilst the rules set out how firms should act to deliver the principle across all areas of conduct and the outcomes show detailed expectations against key elements of the firm-consumer relationship.

Principle
The FCA proposes a new Principle 12:
'A firm must act to deliver good outcomes for retail clients'.

This sets a higher standard than Principles 6 (treat customers fairly) and 7 (communicate clearly) as it emphasises consumer interests and financial objectives. As such, these principles will be disapplied where the Consumer Duty applies. Where a firm is acting in accordance with guidance on Principles 6 and 7, this should not be relied upon alone in considering how to comply with the Consumer Duty, as meeting the rules and outcomes requirements must also be considered.

Rules
The three cross-cutting rules which set out to how to deliver Principle 12 are:

i) act in good faith towards retail customers
ii) avoid causing foreseeable harm to retail customers
iii) enable and support retail customers to pursue their financial objectives.

These rules are supported by the four outcomes. For example, acting in good faith in customer interactions is compliant with the outcome rules on consumer understanding. The rules work as a package because poor conduct will often breach more than one rule, including if a firm exploits a customer's behavioural biases by not clearly explaining exit fees, which would be acting in bad faith as well as not allowing the customer to pursue their financial objectives nor avoiding potential harm to the customer. Equally, these rules should be considered across the outcomes, including at product design, in communications and through consumer support.

Although meeting the Duty requirements should allow firms to adequately equip consumers to make the right choices for themselves, neither the Principle nor the rules translate into a fiduciary duty for firms, as consumers still have the ultimate responsibility for their choices. The intention is not to impose a Duty that will protect consumers from all harm nor go beyond the scope of the firm's ability to do so. This is because the Consumer Duty is underpinned by a concept of reasonableness, meaning the rules and outcomes should be interpreted in line with what can be reasonably expected from firms. Firms cannot be expected to protect their customers from risks they understood and accepted, and sometimes harms will occur due to circumstances that are not reasonably foreseeable for a firm to predict, for example if wider market conditions change the suitability of a product for a consumer. During reviews, a harm that does become foreseeable then becomes the responsibility of the firm.

Due to the varying nature of products and services being offered, what is reasonable depends on the firm, the sector and the type of consumer. Firms should take this information into account when considering how to deliver the Duty. For example, if a particular product is more complex, clearer communications for consumer understanding will be required. If a particular product has a very narrow target market, more attention must be paid to the distribution strategy. These aspects vary in relation to consumer type (e.g. vulnerable customers) and the firm's role in relation to the product or service (e.g. manufacturer has higher degree of control in product design stage). This means firms must be proactive in identifying potential harms and take action to mitigate them where they exist.

Outcomes

The four outcomes identify key components in the firm-consumer relationship where the Principle should be met and the cross-cutting rules should be applied. The outcomes are:

i) products and services
ii) price and value
iii) consumer understanding
iv) consumer support

<u>Products and Services</u>

Harm occurs in retail markets when products or services are poorly designed or distributed to an unintended consumer group. Outcomes are better for consumers when products and services are fit for purpose. To meet this aim, firms should design and distribute products and services with the cross-cutting rules in mind. By analysing the target market, firms can identify the needs of their customers and those with vulnerable characteristics. They can then ensure the design and distribution is appropriate for that group by considering the risk profile, complexity and nature of the product or service.

Manufacturers should undertake appropriate testing of products and services to make sure they meet consumer needs and are distributed via the appropriate channels. Distributors of a product or service will need to obtain information from the manufacturers to fully understand the product or service they will distribute against their distribution arrangements. All firms responsible for design or distribution are required to carry out regular reviews to check products and services continue to meet consumer needs, and distributors should share relevant sales information to support manufacturers' reviews. If consumers with protected characteristics experience different outcomes from a product or service than other customers, firms are expected to investigate and remedy the causes of this. Where firms comply with existing rules in the Product Intervention and Product Governance Sourcebook, (PROD 3), they will tend to comply with the products and services obligations of the Consumer Duty, but should still be reviewed.

What bad looks like	What good looks like
A product or service is marketed or distributed to a group of consumers for which the product or service is incompatible, such as a complex investment product being marketed to novice/high risk investors without advice	The target market for a product or service is clearly defined, meaning the manufacturer provides the distributor with all relevant information about the product. The distributor assesses whether the high-risk product is appropriate for the consumer, and ensures it is

	only sold to the customer if they are in the intended target market
A firm does not consider the suitability of their product or service contract terms, resulting in unreasonable exit fees which discourage consumers from leaving products or services when they are no longer right for them	A firm identifies that a product or service has a high rate of late payment fees, meaning the product or service is not suitable for the current customers. The product is revised to only be lent to consumers with high financial resilience to mitigate harm

Price and Value

Harm occurs for retail consumers when they do not receive fair value for their money from products and services, or when pricing structures are opaque. Firms cannot act in good faith if they are knowingly selling poor value products or services. Poor value does not only equate to high prices, but can also constitute poor communications, poor customer interactions, or unsuitable product features. Firms should seek to provide fair value by considering whether the total price paid by the consumer is reasonable in relation to the benefits offered by the product or service. Firms can achieve prices which are proportionate to their value by considering consumer lack of knowledge and avoiding exploiting these behavioural biases on different consumer groups. Firms also need to consider non-financial costs incurred by a consumer, such as time and effort taken to access, buy, query or cancel a product.

This requirement applies to firms that do not have a direct customer relationship, as they need to consider their role in the value chain and how this affects the price the consumer pays. Manufacturers will be expected to assess value at the design stage by considering the market rates, nature, quality, limitations and total price of a product, in addition to the costs incurred by the firm in product creation and the relevant utility of the product to consumer groups. The manufacturer should consider the costs throughout the whole product lifecycle, such as interest charges or exit fees. At the point-of-sale, distributor firms should assess whether their own distribution charges represent fair value and *whether any remuneration they receive would result in the product/service ceasing to provide fair value*. All firms in the chain are responsible for the value of the prices they control. The final firm in the chain should consider whether the overall proposition provides fair value, as fees charged by firms along the chain might result in a higher overall fee. Value assessments should be ongoing, taking consumer surveys and complaints data into account. Where poor value is identified, firms should amend the product or service and/or provide redress.

What bad looks like	What good looks like
A manufacturer does not provide the firms in the distribution chain with the relevant information to carry out their own value assessments. The end firm in the chain does not set fair value charges as it fails to take into account the level of consumer support required for product distribution, leading to foreseeable harm	A firm assesses its remuneration arrangements and finds some are too flexible when allowing intermediaries to set their commission, which passes on overpriced services to the consumer. The firm acts in good faith to amend the arrangements to control for price and avoid foreseeable harm

Consumer Understanding

Harm can arise in markets when customers are unequipped to understand their products and services, features and risks, and the implications of any decisions they make. The Consumer Duty requires firms to focus on consumer understanding throughout the customer journey. These proposals go further than Principle 7 and the previously named ‘communications’ outcome, as although clear communications are necessary, communications must also support and enable customers to make choices which pursue their financial objectives and avoid harm. In addition to presenting information clearly, information must be presented at different key touchpoints, such as when a product or service is being renewed or a fixed rate is terminating. Good communications are layered, engaging, relevant, simple and well-timed, regardless of which channel is used (face-to-face, telephone, online). Communications must also be tailored to meet the needs of different customers and take vulnerability into account. These considerations of recipients’ capabilities to understand an offering should be informed by their assessment of the make-up of a product or service’s target market.

These rules apply to all firms involved in producing, marketing or distributing communications material at every stage of the product or service lifecycle, including post-sale. For example, instructions on how to cancel a product should be given as much detail and clarity in communications as how to purchase the product. The FCA expect firms to undertake testing of communications for understanding through consumer surveys where there is significant risk of harm arising from consumer misunderstanding. Where communications are not likely to be understood by the average intended customer, do not meet the information needs of different customers nor equip customers to make decisions that are effective, timely and properly informed, they will need to be revised to meet the Duty requirements.

What bad looks like	What good looks like
A firm frames communications in a way which exploits consumers’ behavioural biases, such as presenting the credit option with more prominence through an online sales journey and making other options harder to find or access. This can lead to harm as credit may not be suitable for the customer	A firm tests its online sales journey from a customer standpoint and reorganises information in a logical way, clearly signposting the different options available and explaining which option may be most suitable for different customer types, as well as highlighting the benefit and risks of each option so consumers can make effective decisions

<u>Consumer Support</u>

Consumers can experience harm when customer service is slow, under-resourced, restricted to one channel or difficult to navigate. These can prevent the customer from complaining or getting the appropriate or anticipated use out of a product or service. The consumer support outcome aims to set an appropriate standard of support that all firms must provide to consumers throughout their relationship to ensure this does not occur. Consumers can only pursue their financial objectives where the firm supports them in using the products and services in their interests, without unreasonable barriers. Some barriers, such as slowing down a customer journey to make them aware of a product’s risks, are considered reasonable. As with the ‘consumer understanding’ outcome, the FCA proposes to rename this from ‘customer service’ to ‘consumer support’ to indicate what firms should focus on and that this outcome is not only limited to after-sale service or a particular department within firms. Where exceptional events (e.g. pandemics) impact a firm’s ability to provide its usual level of consumer support, firms should inform customers of this in line with consumer understanding.

The revised requirements are for firms to consider the support their customer base needs and make sure their customer service takes these needs into account, and to monitor the quality of the support they are offering and ensure this caters to vulnerable customers. For example, a firm could offer multiple channels of communication so that consumers who are digitally-excluded can receive face-to-face customer service. As with all outcomes, consumer support should be monitored on an ongoing basis through feedback/satisfaction surveys, complaint analysis and metrics (eg. abandoned calls).

What bad looks like	What good looks like
A firm does not monitor consumer support processes and fails to identify a repeated issue with its phone service where customers are being cut off when transferred to a department. Customers are thus unable to seek assistance on use of their product, causing harm.	A firm monitors its phone services and notes high rates of abandoned calls when transferring to a department. The firm makes changes to the phone system to support customers in accessing support first-time around.

Next steps

Implementation
The FCA suggests firms should have until *30 April 2023* to fully implement the Consumer Duty. The policy statement summarising responses and any new rules will be published by *31 July 2022*. This gives firms a nine-month timeframe in which to implement the proposals.

Monitoring
Firms will be expected to monitor consumer outcomes before and after the implementation period.

They should identify and manage risks to good outcomes, spot where consumers are getting poor outcomes, understand the root causes of these and put processes in place to adapt and change products and services to address these harms. Firms will need to be able to demonstrate how they have used data from complaints, customer feedback and testing to identify and address issues leading to poor outcomes.

The FCA will also monitor the implementation of the Consumer Duty and work with industry where swift and decisive interventions are required. Itis keen to engage with stakeholders to identify where further examples of good and poor practice are required.

Enforcement
The FCA will detect, triage and act on breaches of the Consumer Duty to protect consumers from foreseeable harm. Where it detects serious misconduct by firms in relation to the Consumer Duty, it will use the full range of its regulatory powers to tackle this, including investigation, deterrent and remedial powers such as fines against firms or securing redress for consumers. The FCA does not propose attaching a Private Right of Action to the Consumer Duty, it prefers existing routes of redress which are low-cost and consumer friendly.

Incorporation with SMCR
The FCA proposes to amend the SM&CR individual conduct rules in the Code of Conduct sourcebook (COCON) by adding a new rule requiring all conduct rules staff within firms to 'act to deliver good outcomes for retail customers' where their firms' activities fall within scope of the Consumer Duty. Where this new rule applies, the existing individual conduct Rule 4, which requires conduct rules staff to 'pay due regard to the interests of customers and treat them fairly', will not apply.

Useful Links

A new Consumer Duty: feedback to CP21/13 and further consultation, Previous consultation on A new Consumer Duty, BVRLA Response to Consumer Duty Consultation.

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