THE CONSUMER DUTY

Gethin Thomas

1 Integrity	**A firm must conduct its business with integrity.**
2 Skill, care and diligence	A firm must conduct its business with due skill, care and diligence.
3 Management and control	A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
4 Financial prudence	A firm must maintain adequate financial resources.
5 Market conduct	A firm must observe proper standards of market conduct.
6 Customers' interests	A firm must pay due regard to the interests of its customers and treat them fairly.
7 Communications with clients	A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.
8 Conflicts of interest	A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.
9 Customers: relationships of trust	A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment.
10 Clients' assets	A firm must arrange adequate protection for clients' assets when it is responsible for them.
11 Relations with regulators	A firm must deal with its regulators in an open and cooperative way, and must disclose to the FCA appropriately anything relating to the firm of which that regulator would reasonably expect notice.
12 Consumer Duty	A firm must act to deliver good outcomes for retail customers.

WHAT IS THE CONSUMER DUTY?

- PRIN 2.A of the Handbook
- FG22/5 Non-Handbook Guidance
- It is underpinned by the concept of reasonableness – an objective test.
- *'The obligations on firms will be interpreted in accordance with the standard that could reasonably be expected of a prudent firm carrying on the same activity in relation to the same product and services, taking appropriate account of the needs and characteristics of customers in the relevant target market.'*
- Three main factors:
  a. The nature of the product or service being offered
  b. The characteristics of customers in the relevant target market
  c. The firm's role in relation to the product or service

WHO DOES THE CONSUMER DUTY APPLY TO?

- **"All firms with a key role in delivering retail customer outcomes, including those with no direct customer relationship."**
- "For **consumer credit**, the Duty applies to all regulated credit-related activities.
- For **deposit-taking activities**, the Duty applies to consumers, micro-enterprises, charities with a turnover of less than £1 million and a natural person acting in a capacity as a trustee if acting for purposes outside their trade, business or profession (in line with the 'banking customer' test in the Banking Conduct of Business Sourcebook (BCOBS)).
- For **insurance**, the scope follows the position in the Insurance Conduct of Business Sourcebook (ICOBS). The Duty does not apply to reinsurance, contracts of large risk sold to commercial customers or other contracts of large risk where the risk is located outside the UK. Nor does it apply to activities connected to the distribution of group insurance policies or the extension of these policies to new members.
- For **investments**, the Duty applies to business conducted with a customer who is not a professional client, as set out in the Conduct of Business Sourcebook (COBS).
- For **mortgages**, the Duty follows the position in the Mortgage Conduct Business Sourcebook (MCOB). The Duty therefore applies to all regulated mortgage contracts within the perimeter but not, for example, unregulated buy-to-let contracts or commercial lending. Where the owner of a mortgage book is unregulated and the regulated party is an administrator, the Duty would apply in an appropriate and proportionate manner to the administrator's function.
- For **payment service or e-money providers**, the Duty applies to business conducted with consumers, micro-enterprises and small charities (where the definitions of these terms are the same as for deposit takers, as noted above."

PROFESSIONAL CLIENTS?

"In relation to investments, the Duty does not apply to customers who elect to be treated as professional clients under COBS. It does, however, apply to the process a firm uses to determine a client's status. A firm that encourages a customer to seek a 'professional client' classification simply to avoid providing consumer protection would breach the Duty. If a firm is aware that a customer has been incorrectly classified by another firm earlier in the distribution chain, including an unauthorised firm, it should reclassify the customer and provide the correct level of consumer protection."

DISTRIBUTION CHAIN

- It applies throughout the distribution chain: all firms involved in the manufacture, provision, sale and ongoing administration and management of a product or service to the end retail customer.
- Applies to firms that can determine or influence:
  - the design or operation of retail products or services, including their price and value
  - communications with retail customers
  - customer support for retail customers

WHY INTRODUCE A CONSUMER DUTY?

- The FCA explain that the purpose of the consumer duty is to provide retail customers with a high level of protection, which is required because:
  - they typically face a weak bargaining position in their relationships with firms;
  - they are susceptible to cognitive and behavioural biases;
  - they may lack experience or expertise in relation to products offered through retail market business; and
  - there are frequently information asymmetries involved in retail market business.

WHEN DID IT COME INTO FORCE?

- Open products (i.e. purchased/contracted after 31 July 2023): **31 July 2023**
- Closed products (all existing contracts with retail customers entered into before 31 July 2023 or open for renewal on or after that date): **31 July 2024**

THE THREE CROSS-CUTTING RULES

(1) Firms must act in good faith towards retail customers

(2) Firms must avoid foreseeable harm

(3) Firms must enable and support retail customers to pursue their financial objectives

Example:

"…acting in good faith is a key part of creating an environment in which customers can make decisions in their own interest and pursue their financial objectives. It is also a key part of acting to avoid causing foreseeable harm. If a firm continues to sell a product it knows to be causing harm, it is also likely to be acting in bad faith."

CROSS CUTTING RULE (1): GOOD FAITH

- **PRIN 2A.2.3 G** - Examples of where a firm is not acting in good faith would include:

  (a) failing to take account of retail customers' interests, for example in the way it designs a product or presents information;

  (b) seeking inappropriately to manipulate or exploit retail customers, for example by manipulating or exploiting their emotions or behavioural biases to mis-lead or create a demand for a product;

  (c) taking advantage of a retail customer or their circumstances, for example any characteristics of vulnerability, in a manner which is likely to cause detriment;

  (d) carrying out the same activity to a higher standard or more quickly when it benefits the firm than when it benefits the retail customer, without objective justification.

- **BUT** don't forget – its legitimate to pursue commercial interests/profit.

CROSS-CUTTING RULE (2): AVOID FORESEEABLE HARM

- Avoiding causing foreseeable harm to retail customers includes:

  (1) ensuring all aspects of the design, terms, marketing, sale of and support for its products avoid causing foreseeable harm;

  (2) ensuring that no aspect of its business involves unfairly exploiting behavioural biases displayed or characteristics of vulnerability held by retail customers;

  (3) identifying the potential for harm that might arise if it withdraws a product, its products change or its understanding about the impact on retail customers changes;

  (4) responding to emerging trends that identify new sources of harm, including FCA supervisory action and/or communications; and

  (5) taking appropriate action to mitigate the risk of actual or foreseeable harm

CROSS-CUTTING RULE (2): AVOID FORESEEABLE HARM

BUT:

(1) a product may have inherent risks which retail customers accept by selecting that product. Where a firm reasonably believes a retail customer understands and accepts such risks, it will not breach the rule if it fails to prevent them;

(2) whether such a belief is reasonable will depend (among other things) on the nature of the product offered by the firm, the adequacy of the firm's product design, communications and customer services; and the extent to which it is compliant with applicable law in relation to the sale of that product, including the rules set out in PRIN 2A; and

(3) examples of risks which are inherent to a product include that a mortgage carries a risk of repossession and most investments carry a risk that the market may move resulting in capital loss.

CROSS-CUTTING RULE (3): ENABLE AND SUPPORT

(1) ensuring all aspects of the design, terms, marketing, sale of and support for its products meet and not frustrate the objectives and interests of retail customers;

(2) making sure retail customers have the information and support they need, when they need it, to make and act on informed decisions;

(3) enabling retail customers to enjoy the use of their product and to switch or exit the product where they want to without unreasonable barriers or delay; and

(4) taking account of retail customers' behavioural biases and the impact of characteristics of vulnerability in all aspects of customer interaction.

THE FOUR OUTCOMES

- Products and services outcome;
- Price and value outcome;
- Consumer understanding outcome;
- Consumer support outcome.

OUTCOME (1): PRODUCTS AND SERVICES

- This outcome requires firms to:
  - ensure that the design of the product or service meets the needs, characteristics and objectives of customers in the identified target market
  - ensure that the intended distribution strategy for the product or service is appropriate for the target market
  - carry out regular reviews to ensure that the product or service continues to meet the needs, characteristics and objectives of the target market

OUTCOME (1): PRODUCTS AND SERVICES

"Some life assurance products include terminal illness benefit. Under this, the policy will pay out if a customer is diagnosed with one of a list of medical conditions and has a life expectancy of less than, in general, 12 months. In practice, however, some customers find the claims process difficult to navigate, particularly at a time when they should almost certainly be regarded as having characteristics of vulnerability. Customers may feel discouraged from pursuing a claim through the pre-claims customer journey if claims agents assess the initial call inappropriately. evidence based on the clinical notes. Claims may also be rejected without appropriate consideration; for example, where firms disagree with the customer's medical practitioner without strong Firms designing, or reviewing, products with terminal illness benefit should consider their obligations under the products and services outcome. They should, for example, consider whether the criteria for a diagnosis to lead to a pay out under terminal illness benefit meet the needs, characteristics and objectives 43 of the target market."

OUTCOME (1): PRODUCTS AND SERVICES

- Has the firm specified the target market of its products and services to the level of granularity necessary?
- How has the firm satisfied itself that its products and services are well-designed to meet the needs of consumers in the target market, and perform as expected? What testing has been conducted?
- How has the firm identified if the product or service has features that could risk harm for groups of customers with characteristics of vulnerability? What changes to the design of its products and services is it making as a result?
- Is the firm sharing all necessary information with other firms in the distribution chain, and receiving all necessary information itself?
- How is the firm monitoring that distribution strategies are being followed and that products and services are being correctly distributed to the target market?
- What data and management information is the firm using to monitor whether products and services continue to meet the needs of customers and contribute to good consumer outcomes? How regularly is it reviewing this data and what action is being taken as a result?
- Where the firm is planning to withdraw a product or service from the market, has the firm considered whether this could lead to foreseeable harm? What action is it taking to mitigate this risk?

OUTCOME (2): PRICE AND VALUE

- PRIN 2.A.4.1 defines the concept of value for the purposes of this outcome:

(1) value is the relationship between the amount paid by a retail customer for the product and the benefits they can reasonably expect to get from the product; and
(2) a product provides fair value where the amount paid for the product is reasonable relative to the benefits of the product.

- There is a general obligation of manufacturers to:

(1) ensure that its products provide fair value to retail customers in the target markets for those products; and
(2) carry out a value assessment of its products and review that assessment on a regular basis appropriate to the nature and duration of the product.

OUTCOME (2): PRICE AND VALUE

- **Poor practice**: One example of poor practice we observed in our cash savings work was firms grouping products together in the same fair value assessment, despite material differences in interest rate structures and terms and conditions (eg, instant access, restricted access and fixed term accounts). These material differences could significantly impact the quality of assessment.

- **Poor practice:** Poor practice on benchmarking and outlier analysis included firms only examining their product against a favourable subset of the relevant market and/or portfolio, making positive assessment outcomes more likely. Some firms failed to take account of the effects of significant features of their products in their assessments, which then meant the firm could not fully capture how the product compared with others in the market. This made favourable conclusions on value more likely.

OUTCOME (3): CONSUMER UNDERSTANDING

- **PRIN 2A.5.3:**

(1) A firm must support retail customer understanding so that its communications:

(a) meet the information needs of retail customers;

(b) are likely to be understood by retail customers; and

(c) equip retail customers to make decisions that are effective, timely and properly informed.

(2) A firm must communicate information to retail customers in a way which is clear, fair and not misleading.

OUTCOME (3): CONSUMER UNDERSTANDING

- **PRIN 2A.5.7:**
- In supporting the understanding of retail customers through its communications, a firm should:

(1) explain or present information in a logical manner;

(2) use plain and intelligible language and, where use of jargon or technical terms is unavoidable, explain the meaning of any jargon or technical terms as simply as possible;

(3) make key information prominent and easy to identify, including by means of headings and layout, display and font attributes of text, and by use of design devices such as tables, bullet points, graphs, graphics, audio-visuals and interactive media;

(4) avoid unnecessary disclaimers; and

(5) provide relevant information with an appropriate level of detail, to avoid providing too much information such that it may prevent retail customers from making effective decisions.

OUTCOME (4): CUSTOMER SUPPORT

- **FCA's examples:**
- Consistently poor or excessively slow service
- Channels of support that do not meet the needs of customers, including customers dealing with non-standard issues, and customers with characteristics of vulnerability
- Under-resourced customer helplines, for example where firms disproportionately focus on pre-sales, over after-sales, support
- phone systems, menus or webchats that are difficult to navigate
- Badly designed websites that make it difficult for customers to find key information online
- Uncertainty around how or where to access support, or poor hand-off processes, including where third parties are involved in its provision

MONITORING

- The monitoring carried out by a firm must enable it to determine at least:

(1) whether retail customers are being, or have been, sold products that have been designed to meet their needs, characteristics and objectives;

(2) whether the products that retail customers purchase provide fair value and appropriate action has been taken to address products identified as not providing fair value;

(3) whether retail customers are equipped with the right information to make effective, timely and properly informed decisions; and

(4) whether retail customers receive the support they need.

SUPERVISION

- FCA's reviews:
  - February 2024: Implementation of the consumer duty
  - June 2024: Insurance
  - October 2024: Price and value
  - October 2024: Payment service
- Role of the Financial Ombudsman Service