

Focusing on the details

Planning for a new Consumer
Duty



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As firms plan ahead for 2022, one of the items at the top of their to-do-lists will be planning for the new Consumer Duty. Shortly before Christmas, the FCA published a second consultation on its plans for the new Consumer Duty (CP21/36) which it considers will “fundamentally shift the mindset of firms” and establish an appropriate level of care to consumers. This second Consultation Paper expands on the FCA’s proposals and also sets out feedback to the first Consultation Paper (CP21/13), together with the FCA’s response.

Sheldon Mills, the FCA’s executive director of consumers and competition said, “Making good financial decisions is vital to financial well-being and trust, but too often consumers are not given the information they need to make good decisions and are sold products or services that do not offer the benefits they might expect. We need to change that. We’ve been working to set a higher standard for firms, to put more of the onus on them to act in their customers’ interests and get their products and services right”. He added, “The new duty will drive a change in culture. We expect firms to step up and put consumers at the heart of what they do and we’ll be holding senior managers accountable if they do not. The duty will also help create an environment for healthy competition between firms, encouraging them to be innovative in developing products and services that meet consumers’ needs”.

Firms have until 15 February 2022 to respond to the consultation, with the FCA inviting feedback on the impact of its proposals and on the substance of its draft rules and non-Handbook guidance. The FCA expects to publish the new rules by 31 July 2022 with the implementation period then expected to run until 30 April 2023. There is a lot for firms to do in this relatively short nine month period. Firms will be expected to review their existing and incoming products and services (including making updates to any customer-facing documents such as Terms and Conditions) and take actions to fully implement the Consumer Duty.

The significance of the impact to firms is highlighted by the FCA’s cost benefit analysis of introducing the new Consumer Duty. It estimates that the total one-off direct costs firms may incur to comply with the Consumer Duty could be up to £2.4 billion (incurred in performing gap analysis on their policies and processes, making relevant adjustments through change projects, training staff on the new requirements, as well as IT costs from system changes and costs to monitor and test consumer outcomes). The ongoing annual direct costs are expected to be in the range of £74 million to £176.2 million. In addition, the FCA anticipates (but does not quantify) firms incurring indirect costs in the form of potential loss in profits due to changes they make to their product design and prices. Even though these estimated costs of implementation appear large, we still consider that they may be an underestimate taking into account the amount of work that firms need to do to implement the new Consumer Duty.



What is the new Consumer Duty?

The new Consumer Duty is intended to set higher expectations for the standard of care that firms provide to consumers and will comprise three key elements:

- A new Consumer Principle (Principle for Businesses 12) that would replace FCA Principles 6 and 7 for retail business: “A firm must act to deliver good outcomes for retail clients”.
- Three cross-cutting rules which require firms to:
 - act in good faith towards retail customers;
 - avoid causing foreseeable harm to retail customers; and
 - enable and support retail customers to pursue their financial objectives.
- Four outcomes the FCA expects the new rules to achieve:
 - The product and services outcome: consumers are sold products and services that have been designed to meet their needs, characteristics and objectives.
 - The price and fair value outcome: consumers are sold products and services that represents fair value to them.
 - The consumer understanding outcome: consumers are equipped with the right information to make effective, timely and properly informed decisions.
 - The consumer support outcome: customers receive the support they need.

It will be interesting to see whether the new Consumer Duty meets its objective of setting a higher standard of care that firms provide to consumers. One observation on the proposed new Principle 12 is that the FCA has not taken on board the concerns that a fair outcome is not always a good outcome from a customer's perspective. There will continue to be situations in which a customer is disappointed (for example, by the performance of an investment) even where a firm has complied with both the letter and spirit of the new Consumer Duty. Good practices do not always result in good outcomes and, as such, it will be for the FCA to distinguish between good and fair outcomes, regardless of the drafting of the duty.



The second consultation

CP21/36 clarifies and expands on the FCA's proposals in a number of areas, including:

The proposed scope of the Consumer Duty

The FCA is proposing that the scope of the Consumer Duty will be aligned to the existing areas of its sectoral sourcebooks, i.e. the scope of the Consumer Duty for insurance will follow the position in ICOBS, whilst for mortgages, the scope will follow the position in MCOB. The FCA has also confirmed that it intends to the Consumer Duty to apply to prospective customers as well as a firm's existing customer base.

The new Consumer Duty will impose a higher standard than existing Principles 6 and 7, which cover treating customers fairly and client communications. The FCA states that it will impose a "higher and more exacting" standard of conduct in relation to firms' retail market business. It will also apply more broadly than Principles 6 and 7, with greater focus on consumer protection outcomes for retail clients of a product whether the retail customers have a client relationship with firms in the product chain or not. Any firm that has the ability, through its regulated activities, to influence the outcomes experienced by a retail customer will be caught. This can be by the way it designs a product or distributes it, so the new Consumer Duty will apply along the supply chain.

In terms of the application of the new Consumer Duty to multiple firms in distribution chains, it is positive that the rules are intended to apply proportionately, taking account of a firm's particular role. Firms are only expected to take responsibility for their own activities and should not need to oversee the actions of other in the distribution chain. However, in practice, the application of these principles is likely to be far from straightforward. For example, where end users in a complex distribution chain do not achieve good outcomes, activities of all firms in that distribution chain (including ancillary unregulated activities which are connected to a regulated activity) are likely to come under scrutiny irrespective of how close a firm's relationship is with those end users. Further, whilst the FCA argues that "potential complications in contractual relationships should not arise", this may not reflect reality as firms look to implement the new requirements.



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Application of Principles 6 and 7

As set out above, it is proposed that a new Consumer Principle (Principle 12) will replace FCA Principles 6 and 7 for retail business: "A firm must act to deliver good outcomes for retail clients".

However, for the avoidance of doubt, Principles 6 and 7 will continue to apply to any conduct that is outside the scope of the new Consumer Duty, for example, with respect to certain small and medium-sized enterprises ("SMEs") and the wholesale business.

The FCA has said that the new Consumer Duty will impose a higher standard than the existing Principles 6 and 7. It will be interesting to see how this higher standard is applied in practice.

We can see a difference from the obligations under Principle 7 in the new consumer understanding outcome. The FCA wants firms' communications to support and enable consumers to make informed decisions about financial products and services. Consumers need to be given the information they need, at the right time, and presented in a way they can understand. In the first Consultation Paper (CP21/13), this was badged the "communications" outcome but has been renamed as the "consumer understanding" outcome to emphasise the outcomes the FCA wants firms to focus on, and so goes beyond the communications focused Principle 7.

Retrospective application

Whilst the Consumer Duty will not apply to firms' past actions, the FCA intends for it to apply on a forward-looking basis to existing products and services that are either still being sold to customers, or closed products and services that are not being sold or renewed.

It is helpful that the FCA has been clear that the new Consumer Duty will have no retrospective effect. However, firms will need to review their products and services during the implementation period, and this might mean involve updating contractual terms and conditions of a product or service before it can continue to be sold (or renewed) to new or existing customers following implementation of the Consumer Duty. The FCA notes that significant changes may be required to existing contracts going forwards to meet the requirements of the Consumer Duty.

Duty of care

The FCA does not agree that the Consumer Duty implies a legally enforceable obligation. The FCA has not branded the Consumer Duty as a "duty of care", nor do its proposals comprise a "one-line duty", rather, they are a package of measures specifically designed to tackle consumer harms, and their causes, more effectively.

Private right of action

In light of the concerns raised in response to the first Consultation Paper (CP21/13), the FCA is not intending to make a private right of action available for the Consumer Duty. The regulator's view is that the existing redress framework is likely to be a more appropriate route for almost all consumers to seek redress and it is working closely with the FOS to improve awareness of the existing regime. That said, the FCA will keep the possibility of a private right of action under review, including in light of the evidence it sees of firms' embedding of and compliance with the Consumer Duty.

It is positive that the FCA intends to work closely with the FOS with the aim of having a consistent view on the interpretation of the new Consumer Duty while respecting their different roles. However, care should be taken to avoid discrepancies between the regulator and ombudsman which would only confuse matters and give the industry mixed messages.



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Monitoring

The FCA expects firms to produce and regularly review management information (“MI”) on consumer outcomes which should be appropriate to the nature, scale and complexity of their business, considering the size of the firm, the products or services it offers and the consumer base it serves. The FCA also expects a firm's Board to deliver an annual report assessing whether it is acting to deliver good outcomes for its customers which are consistent with the Consumer Duty.

On an initial glance at the proposals, the monitoring requirements look very similar to the FSA era Treating Customers Fairly (“TCF”) initiative. However, it is fair to say that the FCA will be expecting firms to develop from the TCF baseline to more sophisticated MI and, critically, to something which is set in the context of a strengthened individual accountability regime. It is reasonable to expect that firms' approaches to monitoring will evolve over time as the financial services industry gains more experience of the FCA's approach to the new Consumer Duty.

That the FCA says it is not requiring specific metrics or new reporting may initially seem less onerous, but the FCA expects firms to be able to “demonstrate effectively” how they are monitoring outcomes, identifying harms or the risks arising, and how they address issues they have identified. Further, firms will need to explain how they reached a decision on the most appropriate intervention, demonstrate how that intervention has addressed the concerns that they identified, and delivered good customer outcomes and, if the intervention has not done so, what further they have done to address the issue.

Vulnerable Customers

The importance of considering the needs of vulnerable customers pervades the Consultation Paper. The FCA is clear that there should be flexibility and mechanisms at all points of the consumer journey for considering outcomes for vulnerable customers and those with protected characteristics, in accordance with the FCA's existing guidance on the treatment of vulnerable customers. Echoing comments in the recent Diversity and Inclusion Paper (DP21/2), the FCA emphasises that if groups with protected characteristics are experiencing different outcomes, firms will need to prove to the FCA that these are compatible with the standards required by the new Consumer Duty.

Senior Managers and Certification Regime (“SMCR”)

The Consumer Duty does not require a single senior manager to be responsible for compliance with all aspects. The Consumer Duty imposes expectations across the design, distribution and delivery lifecycle, and each senior manager must take responsibility for the role they play in delivering compliance with it. All senior managers are responsible for ensuring that the business of the firm complies with the requirements of the Consumer Duty on an ongoing basis.

The FCA proposes to amend the SMCR individual conduct rules in Code of Conduct sourcebook (“COCON”) to reflect the higher standard of the new Consumer Duty 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 Rule 4, which requires conduct rules staff to “pay due regard to the interests of customers and treat them fairly” would not apply.

CP21/36 also includes draft non-Handbook guidance which sets out more details for firms on what the Consumer Duty does and does not require (at Appendix 2). It also provides examples of good and bad practice on the four outcomes the FCA wants to see as a result of the Consumer Duty.



Next steps

As set out above, it is expected that firms will have until 30 April 2023 to fully implement the new Consumer Duty. However, as highlighted by the FCA's cost benefit analysis, considering how much work there is to do, firms should not delay putting in place their implementation plan until the rules are finalised in July 2022. Careful reflection will be required, and the plan needs to be agreed with the whole firm, not generated just in the Compliance team.

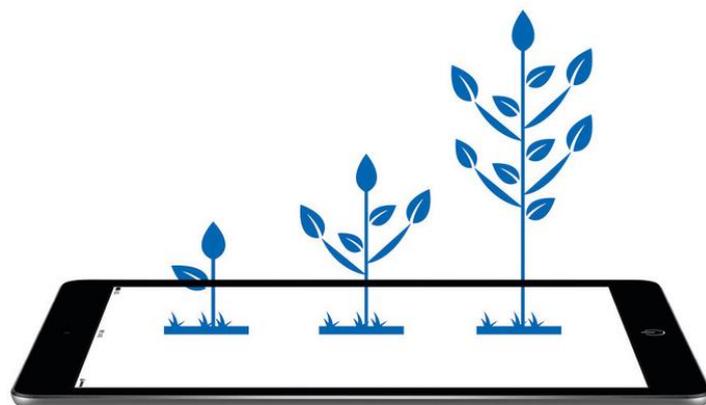
First, firms need to understand and disseminate requirements of the new Consumer Duty. Firms need to move towards a new Consumer Duty mindset, including in the way they use terminology as part of their governance and controls. This should start with the Board, Executive and Senior Management teams, with wider training part of the implementation plan.

Second, firms should conduct a high-level assessment to identify priority issues. It is essential to undertake high-level assessments of customer journeys and key products and services in order to identify priorities for action and key commercial implications. Firms must identify now where they may need to invest to meet the new standards.

Next, firms should review their customer outcomes framework and MI. Firms need to make sure that the new Consumer Duty outcomes are reflected in conduct frameworks and processes, and that there is specific MI that aligns with the duty. A good starting point is to document exactly when and how a firm has responded and re-focused on the quality of consumer outcomes.

Firms should review product governance framework and processes. Ensuring that the new Consumer Duty is embedded in the way a firm works, and how it documents frameworks and processes is key. This includes how an organisation plans to approach product development, product reviews and fair value assessments. For example, for insurers and insurance distributors, the starting point is likely to be the work undertaken to map products and services as part of the implementation of the new product governance and pricing rules, and supporting product governance and review processes.

Finally, firms should develop and socialise a template for the Board's annual assessment of whether the firm is delivering good conduct outcomes. Firms should get an early idea of what the assessment might entail as well as the results, and get buy-in from the Board for the process. We suggest piloting this exercise as a preliminary assessment, and to help finalise a template for the subsequent formal assessments.



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