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Good Practice Guide

NOVEMBER 2022

A practical guide to Consumer Duty: Personal Finance

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This paper is in response to members' requests to provide a summary of good practice within one source document and is based upon the Personal Finance Society's understanding of the regulators rules and current stance. Whilst a summary, it is not intended to be exhaustive and should not be relied upon at the exclusion of other sources of information.

Introduction
– What is the Consumer Duty? How did it come about?

The Consumer Duty began with a campaign by the Financial Services Consumer Panel to create a statutory 'duty of care'.

In January 2017, the FCA Consumer Panel published a paper arguing that the FCA's requirement to 'Treat Customers Fairly' (TCF) allowed firms 'to be able to adopt a "let's see if we can get away with it" approach' to compliance. In contrast, it contended that under a Duty of Care firms 'would have to avoid conflicts of interest and take their customers' best interests into account at every stage of their engagement... in short, a duty of care would effectively deliver what TCF is intended, but so clearly fails, to do.'[1]

In 2018 the FCA responded by publishing a *Discussion Paper on a duty of care and potential alternative approaches*. This document challenged respondents to the consultation to describe what benefits new rules would have '...over and above the existing regulatory framework...'.[2]

In 2019 the FCA published a feedback statement on the Duty of Care, acknowledging that 'Most respondents consider that levels of consumer harm are high and change is needed to better protect consumers.'[3] It summarised the main arguments for change as:

- A need for culture change, moving firms to ask themselves: 'is this right?' rather than 'is this within the regulations?'
- Greater regulatory clarity, allowing the FCA to act against firms exploiting gaps in existing regulations to create consumer harm
- An emphasis on prevention
- Clarity for consumers and firms

It went on to say that it would look at a range of possible measures, including 'new/revised Principles to strengthen and clarify firms' duties to consumers'

In May and December 2021, the FCA published two more rounds of consultation on the Consumer Duty[4], setting out the proposed changes to its Handbook, and published its final Policy Statement and Guidance in July 2022.[5]

The Consumer Duty and the FCA Handbook
– what's new?

The new Consumer Duty appears at several levels in the handbook. At the highest level, it is summed up in a new principle:

'A firm must act to deliver good outcomes for retail customers'

This principle is elaborated in cross-cutting rules, or obligations. They are:

- A firm must act in good faith towards retail customers
- A firm must avoid foreseeable harm to retail customers
- A firm must enable and support retail customers to pursue their financial objectives

Finally, these cross-cutting rules, which form 'inputs' to the work that firms do, are linked to four outcomes. They are:

- **Products and services** – this covers elements of product governance for providers, distributors and advisers
- **Price and value** – this does not imply a price cap, or a requirement to be the cheapest in the market. It does, however, mean that firms cannot simply charge as much as they think they can get away with. The FCA has said 'Firms should avoid designing products and services to include elements that exploit consumer lack of knowledge and behavioural biases to increase the price paid.'[6]
- **Consumer Understanding** – the FCA makes clear that this does not mean firms must 'verify that all individual consumers have in fact understood the information provided.'[7] However, it suggests that 'One question firms can ask themselves is whether they are applying the same consumer support standards to deliver good consumer outcomes as they are to generate sales and revenue.'[8]
- **Consumer Support** – this requires firms to 'enable consumers to get what they paid for...without unreasonable barriers.'[9]

Organisations' systems and culture
– the heart of the Consumer Duty

What is even more important than the changes in rules is the anticipated change in culture that the FCA talked about in its 2019 feedback statement – looking to firms to ask themselves:

"'is this right' rather than 'is this within the rules'".[10]

During the build up to the Consumer Duty, the FCA has referenced a good practice model that was developed as part of its guidance to customers in vulnerable circumstances.

This is a dynamic model that requires firms to monitor the effect their proposition is having on consumer outcomes. Firms are then expected to analyse the outcomes and learn from them. This means that having a 'cottage industry' of management information is not enough. Firms' senior management are expected to show that they have understood feedback and have used it in refining their firms' proposition, ready to be monitored and analysed again (see Figure 1).

It is also worth reflecting on the 'learning' stage of this cycle. For example, a firm that has a diverse range of employees, or access to a diverse network of experts, is more likely to learn about the implications of feedback than a firm that only looks at analysis through one lens. As the FCA has said in its 2022 Policy Statement, 'diversity is a lens that can help firms to better understand and meet the needs of their customers, including those in vulnerable circumstances. We see significant practical benefits in firms exploring customers' needs from different perspectives.'[11]

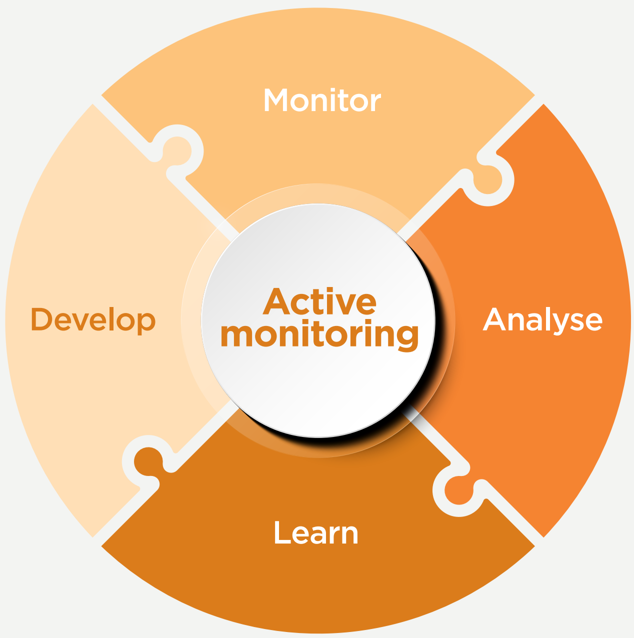

Figure 1: Active monitoring

Consumer Duty and the Ombudsman
– how do they interact?

There has been a lot of discussion about how the Financial Ombudsman Service (FOS) will interpret requirements such as the obligation to 'avoid foreseeable harm to retail customers'. For example, firms are asking if they need to change the way they structure recommendation letters to ensure that there is clear evidence of the adviser having considered factors such as 'foreseeable harm' to demonstrate compliance with the Consumer Duty if a complaint is taken to the FOS in future.

It is worth stressing that the FCA sees the Consumer Duty to be implemented at a segment level, rather than an individual level. It has said, 'Our expectations apply based on what is reasonable. We do not expect firms to exhaustively segment their customer base to identify differences in outcomes between all possible groups of customers.'

For example, if a firm used its knowledge of behavioural biases to 'nudge' its clients towards more volatile investments, and did not react to management information that showed it that certain segments (e.g. clients above a certain age) had a larger than expected proportion of their portfolios invested in these more volatile assets, then it could be argued that firms have not reacted to the 'foreseeable harm' of introducing a particular 'nudge' and the FCA might take action under its supervisory powers.

However, if a single client were to complain to the FOS about the proportion of their portfolio that was in more volatile investments, we would expect the FOS to judge the complaint on its individual merits, just as it would before the Consumer Duty was introduced.

As is the case now, the FCA believes that advisers should consider the overall impact of a recommended set of products and services for a client. It says, 'the adviser can often also have the clearest oversight of the customer's overall position and an overview of the total proposition. In this instance, it should consider the overall outcomes being delivered for the customer. This should include whether the overall cost to the customer, including all product and distribution charges in the distribution chain, provides fair value. The firm should also consider if the customer is given an appropriate level of information about the overall proposition, in a timely and understandable format, to enable the customer to make effective decisions.'

This is in line with existing guidance, such as this example of poor practice set out in the FCA's guidance on pension transfers.

'A client wanted to transfer for higher income as the scheme pension 'represents about 3% of the transfer amount and I think I could get around 6% by investing the funds and adding to their value in the longer term.' The firm made no effort to explain that the 3% figure effectively represented a guaranteed real net yield but that the hoped for, but uncertain, 6% would be a nominal yield, before charges. The figures provided in the subsequent suitability report showed that the projected value of the transferred funds at the client's selected retirement age would be less than the transfer value, mainly due to excessive charges. The firm failed to draw the client's attention to the significantly lower net real yield likely on transfer and how this did not meet their objective.'

As a result, the Consumer Duty underlines existing requirements for advice and record-keeping at an individual client level, rather than creating new ones.

Timeline for changes

The timeline for the Consumer Duty has been extended to 2024, but the FCA has also set out milestones within this time that it expects firms to meet. They are:

- By the end of October 2022, firms' boards (or equivalent management body) should have agreed their implementation plans and be able to evidence their thinking behind these plans in a range of documents such as board minutes.
- Manufacturers should aim to complete all the reviews necessary to meet the four outcome rules for their existing open products and services by the end of April 2023 and share all necessary information with distributors.
- From the end of July 2023, the Duty will apply to all new products and services and all existing products and services that remain on sale or open for renewal.
- Finally, from the end of July 2024, the Duty will apply to all closed products and services.

Case studies

As part of its consultation on the Consumer Duty, the FCA has published a series of case studies highlighting good and poor practice.[12]

A key case study that is particularly relevant to personal finance are:

Poor Practice

An adviser recommends a customer moves assets to a new investment platform. The adviser communicates the instruction to switch the customer's assets to the existing investment platform. However, as there is no commercial benefit to the existing platform in the customer making this switch, it fails to deal with this request in an effective and timely manner.

The adviser regularly contacts the existing platform to check on progress, but it is slow in responding, fails to explain the reason(s) for the delays and/or give an indication of when the switch will be actioned. Unreasonable delays in the moving of assets between investment platforms are likely to result in poor outcomes for the end customer.

Firms are responsible for their own activities and they must meet expectations under this outcome as far as they are relevant to their role. Where firms are outsourcing or using a third-party provider, the usual regulatory principle applies in that firms are responsible and accountable for all the regulatory responsibilities applying to outsourcing and third-party arrangements. Firms cannot delegate any part of this responsibility to a third party.

This means that if a firm chooses to outsource elements of its consumer support to a third party, it is responsible for ensuring the support provided meets the Duty standard. The firm should have systems and controls in place to monitor this and provide assurance that it is meeting its regulatory obligations.

There are no other case studies in the Consumer Duty guidance aimed specifically at advisers, but case studies produced for its 2021 Guidance on Consumers in vulnerable circumstances[13] are also relevant, such as this one:

Good Practice

A firm launched a training tool to educate financial advisers on interacting with older consumers. The tool takes an hour to complete and gives advisers an understanding of what characteristics of vulnerability they are likely to see among their older customer base, how to recognise them and how changes in working practices can ensure they provide additional care and support where necessary.

This firm has been proactive in providing training opportunities for advisers. The training tool is an example of a useful resource that firms may use to improve the skills and capability of staff, at a low cost.

Scope of the consumer duty
– what's covered?

The Scope of the Consumer Duty for activity covered by the Conduct of Business Sourcebook is relatively simple. The rules say that a retail customer 'in relation to activities to which COBS applies, [is] a customer who is not a professional client;

However, for activity covered by ICOBS, the situation is more comples. In May 2021, the FCA said:

'Our proposals relate to products and services sold to 'retail clients'. This is a very wide term that includes all clients other than professional clients (such as large corporate entities and government bodies) and eligible counterparties. So in most cases, where we regulate the provision of financial services to SMEs, these proposals would apply.'[14]

In December 2021, in response to its earlier consultation, it said:

'We recognise that applying a single standard retail client definition to the Consumer Duty could create challenges in different sectors….

'We are therefore proposing to align the scope of the Consumer Duty with the existing scope of our sectoral sourcebooks. For example, for insurance, the scope of the Consumer Duty will follow the position in the Insurance Conduct of Business Sourcebook (ICOBS).'[15]

This need to reconcile the aims of the Consumer Duty with the realities of the existing handbook has created some complexity.

For insurance, the Insurance Conduct of Business Sourcebook (ICOBS) says:

'2.1.1 Different provisions in this sourcebook may apply depending on the type of **person** with whom a **firm** is dealing:

1. A **policyholder** includes anyone who, upon the occurrence of the contingency insured against, is entitled to make a claim directly to the **insurance undertaking**.
2. Only a **policyholder** or a prospective **policyholder** who makes the arrangements preparatory to him concluding a **contract of insurance** (directly or through an agent) is a **customer**. In this sourcebook, **customers** are either **consumers** or **commercial customers**.
3. A **consumer** is any natural person who is acting for purposes which are outside his trade or profession.
4. A **commercial customer** is a **customer** who is not a **consumer**.'[16]

In the rules that apply directly to the Consumer Duty, a retail customer is defined as:

'(1) (other than in PRIN[17]) an individual who is acting for purposes which are outside their trade, business or profession.

(2) (in PRIN): …(b) in relation to activities to which ICOBS applies, a policyholder or prospective policyholder…'[18]

This means that the new Consumer Duty Principle and cross-cutting rules use the definition of a *policyholder* in ICOBS, and not the definition of a *consumer* in ICOBS.

Key Documents

FCA

FG22/5 Final non-Handbook Guidance for firms on the Consumer Duty
www.fca.org.uk/publication/finalised-guidance/fg22-5.pdf

PS 22/9 A new Consumer Duty: Feedback to CP21/36 and final rules
www.fca.org.uk/publication/policy/ps22-9.pdf

Finalised guidance FG21/1 Guidance for firms on the fair treatment of vulnerable customers
www.fca.org.uk/publication/finalised-guidance/fg21-1.pdf

FCA Consumer Panel

A Duty of Care for Financial Services Providers
https://fs-cp.org.uk/sites/default/files/duty_of_care_briefing_-_jan_2017.pdf

Chartered Insurance Institute

Building trust through ethical culture: A Guide for SME firms
https://www.cii.co.uk/news-insight/insight/articles/building-trust-through-ethical-culture-a-guide-for-sme-firms-updated/84323

www.cii.co.uk/media/10125630/chartered-transparency-ethical-companion.pdf 'Transparency and insurance a Companion to the Code of Ethics'

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