

Insights

FCA PROPOSES NEW CONSUMER DUTY – TCF WITH BIGGER TEETH?

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SUMMARY

On 14 May 2021, the FCA published Consultation Paper [CP21/13](#) outlining much-anticipated proposals relating to the standards expected of regulated firms to ensure the protection of retail consumers. The Consultation Paper follows a recently published [speech](#) given by Charles Randell, Chair of the FCA and PSR, in which Mr. Randell outlined changes required to transform regulation and reshape the FCA to better protect consumers. Indeed change in this area has been on the cards for quite some time. In January 2020, fellow BCLP partner Nathan Willmott predicted in our [Emerging Themes in Financial Regulation 2020](#) publication that the FCA would bolster the Principle 6 duty to treat customers fairly and add a new Principle and high level obligations requiring firms to adopt fair pricing practices. Although these proposals were delayed by the COVID-19 pandemic, which the FCA recognise in their Consultation Paper, it would appear that plans are now coming to fruition.

At their core, the FCA's proposals are driven by a desire to ensure that consumers have access to the range of products and services that meet their needs and offer fair value. In order to achieve this aim, the FCA is consulting on the introduction of a new Consumer Duty in relation to all products and services sold to retail clients (i.e. all clients other than professional clients and eligible counterparties). According to the FCA, the proposed duty would help to ensure a higher level of consumer protection in retail financial markets and encourage firms to "compete vigorously in the interests of consumers".

As we discuss below, the FCA proposes that the new Consumer Duty will comprise a new Consumer Principle outlining the overall standard of conduct expected of firms, along with three new behaviour-driven Cross-cutting Rules and four new Outcomes.

A CONSULTATION PAPER THREE YEARS IN THE WORKS?

Reform regarding consumer protection has long been touted by the FCA. In July 2018, the FCA published a Discussion Paper on a duty of care and potential alternative approaches ([DP18/05](#)) in

response to concerns that the FCA's Principles do not always sufficiently protect consumers. The regulator used the Discussion Paper as a platform to seek views on gaps in the FCA's framework in relation to protection of consumers, and to canvass opinion on the merits of a new duty of care to consumers.

Fast forward to April 2019 and the FCA published a subsequent Feedback Statement (FS19/2), which outlined the responses to DP18/05. The FCA's key takeaway from respondents was that the majority considered levels of harm to consumers to be "high" and that change to the regulatory framework was necessary. However, it was less clear from the responses how such change should be effected: some respondents called for a statutory duty, some for a new FCA Principle, and some pointed to the fact that the Senior Managers & Certification Regime ("SM&CR") may in fact bring about the necessary change without the need for a new duty. The FCA concluded that it would review its application of the regulatory framework, consider implementing "new/revised Principles to strengthen and clarify firms' duties to consumers", and consider the pros and cons of allowing private rights of action for breaches of Principles.

Since then, the FCA has published a separate 'Guidance for firms on the fair treatment of vulnerable customers' (FG21/1). The Guidance provides examples of harm and disadvantage that firms should be alert to when dealing with vulnerable customers, and sets out the steps that firms should take to achieve good outcomes for such customers. Crucially, the FCA states in the Guidance that it will apply a "vulnerability lens" to supervision and enforcement of its regulatory framework.

The crux of each of these previous publications is the same as the rationale behind CP21/13, and is neatly summarised by the FCA in the Consultation Paper:

"In short, we want firms to act in good faith, to avoid causing harm, to empower consumers by placing them in a position where they are able to make effective decisions, so that consumers can take responsibility for their actions and decisions".

WHAT ARE THE PROPOSALS?

(a) New Consumer Principle

First, it is suggested that the new Consumer Principle will be included in the FCA Handbook's Principles for Businesses sourcebook (PRIN), and will set a "clear tone and [use] language that reflects the overall standards of behaviour [the FCA wants] from firms". The FCA offers two suggestions for the wording of the Consumer Principle:

- "A firm must act to deliver good outcomes for retail clients". This wording places emphasis on the requirement for firms to consider not just the substance of their actions, but also the impact of their actions on retail consumers.

- “A firm must act in the best interests of retail clients”. This formulation would require firms to ensure that their conduct could reasonably and objectively be said to be in consumers’ best interests.

(b) New Cross-cutting Rules

Secondly, the FCA intends to reinforce the Consumer Principle with three new Cross-cutting Rules that would require firms to:

- Take all reasonable steps to avoid causing foreseeable harm to customers.
- Take all reasonable steps to enable customers to pursue their financial objectives.
- Act in good faith.

(c) New Outcomes

Thirdly, the proposed Consumer Duty will also encompass four Outcomes that the FCA is seeking to achieve via the implementation of the Consumer Principle and Cross-cutting Rules:

- Communications equip consumers to make effective, timely and properly informed decisions about financial products and services.
- Products and services are specifically designed to meet the needs of consumers, and sold to those whose needs they meet.
- Customer service meets the needs of consumers, enabling them to realise the benefits of products and services and act in their interests without undue hindrance.
- The price of products and services represents fair value for consumers.

What is the significance for firms and their senior managers?

The FCA states that for many firms, the proposed changes will “require a significant shift in culture and behaviour, where they consistently focus on consumer outcomes, and put customers in a position where they can act and make decisions in their interests”. In turn, this will require firms to review their products and services from the perspective of consumers: the FCA suggests asking questions such as ‘would I be happy to be treated in the way my firm treats its customers?’, or ‘would I recommend my firm’s products and services to my friends and family?’.

However, there are real question marks over whether the proposals are as significant as the FCA suggests and, importantly, whether they will result in the enhanced clarity for the market and better consumer outcomes that the FCA is hoping to achieve.

Firms and individuals within the scope of the SM&CR are already subject to the FCA's principles-based regulation. In particular, they are required to pay due regard to the interests of customers and treat them fairly (FCA Principle 6) and are also bound by the six Consumer Outcomes which require firms to be able to show consistently that fair treatment of customers is at the heart of their business model.

In addition, firms are subject to numerous other requirements in this space. We note in particular the following provisions:

- The financial promotion rules, as set out in each of the FCA's conduct of business sourcebooks (COBS, ICOBS, MCOB, BCOBS, CMCOB 3 and CONC 3) depending on the nature of the product or service to which the promotion relates. Since both HM Treasury and the FCA are separately consulting on a range of changes to the financial promotion regime, there is a risk that more confusion than clarity will result;
- The client best interest rule in COBS 2.1.1 and its equivalents in other conduct of business sourcebooks (see above);
- The product governance rules from MiFID II (see, in particular, the FCA's Product Intervention and Product Governance Sourcebook ("PROD")) and the residual provisions of the Responsibilities of Providers and Distributors for the Fair Treatment of Customers ("RPPD"). Whilst the provisions in this final bullet only apply to certain firms, for those that are subject to them, there is likely to be a significant cross-over and potential for confusion and conflicting guidance; and
- New rules and evidential provisions on ensuring value for money for consumers of retail insurance products, as separately set-out in FCA Policy Statement PS 21/5 following the FCA's general insurance pricing practices market study, CP 20/19. See our [separate blog](#) on these changes. The FCA itself appears to recognise the real risk of overlapping provisions. Indeed, in the Consultation Paper they briefly consider dis-applying the existing Principles 6 and 7 to reduce this risk, although signalling that this is unlikely to be included in the final provisions. Further, there is no suggestion that there will be disapplication of any of the other provisions that could cause overlap and contradiction.

Putting these concerns aside, however, the proposals do indicate a step-change in the FCA's expectations of firms and their senior managers. The FCA states that the new Consumer Principle will set a higher standard than the Principle 6 requirement, and so it appears that the intention, at least, is for the proposals to be more than a mere re-hash of existing requirements. Although we will have to wait to see where the FCA ultimately lands on this.

Nevertheless, it is clear that the overarching Consumer Principle will provide the FCA with a greater ability to hold firms and individuals to account when the rules come into force next summer. We expect to see an increase in enforcement action for consumer protection failings against firms and

individuals that do not take steps to put in place robust and timely processes in light of these changes. Firms will need to consider training for staff on the new standards and rigorous self-assessment processes to determine compliance and appropriate responses to shortfalls.

These processes clearly represent an additional burden for firms. The FCA should grasp the nettle in addressing concerns about how the new provisions will sit alongside existing provisions, otherwise the risk is that firms are burdened unnecessarily without realising the hoped benefits of clarity.

What is the significance for consumers?

Naturally, the FCA's intention to set clearer and higher standards for the culture and conduct of firms, each with a focus on the actual outcomes experienced by consumers, should be good news for consumers and consumer groups. Importantly, the Consultation Paper acknowledges that in order for vulnerable consumers to achieve the same outcomes as other consumers, firms may need to provide them with an additional level of care. This extends the FCA's focus on the protection of vulnerable customers following the publication of [FG21/1](#).

Consumers will also be pleased to see that the FCA's proposals place importance on products and services offering fair value. It is clear that consumers and the FCA expect more from firms here, so it is not surprising that the proposed fourth Outcome will require firms to price products and services in a way that represents fair value for consumers. Indeed, fair value is a regulatory priority for the FCA across the financial services sector.

Whilst few can dispute the merit in these intentions, there are challenges to them being achieved or for unintended outcomes to arise, including the following:

1. We have discussed above our concerns regarding the confusion and conflict that the new provisions may introduce, which would disadvantage firms and consumers.
2. The cost-benefit analysis of these measures is yet to be published. It is expected to be included in the next stage of the consultation and will give some indication of the extent to which the proposals will actually improve the consumer experience. One can envisage, for example, that there could be increased costs for certain products or services, or a change in the products and services offered to consumers, which may not be welcome.
3. There is also a risk that certain elements of the proposals could inadvertently cause detriment to consumers. For example, the provisions on avoiding causing harm to consumers could mean that investment advisers and managers only recommend the most cautious of investment strategies to retail investors for fear of investment losses being perceived as having caused harm. Similarly, the need to "get it right first time" could also stifle innovation within regulated firms (and with no such constraints on those operating outside the regulatory perimeter). The Consultation Paper does suggest that the FCA is alive to these risks and does not want to make firms responsible for

external risks, but the fear of getting caught up in lengthy investigations and being judged with hindsight will still be of concern to firms.

Separately, we note that the next stage of the consultation will provide further clarity on the FCA's consideration of a new potential private right of action ("PROA") for breaches of its Principles, which would include the new Consumer Principle. The FCA is not consulting specifically on these proposals in CP21/13, but sets out in Chapter 5 what it sees as the pros and cons of extending the PROA to these new measures. The FCA acknowledges that a PROA would be a powerful deterrent for breach and would offer an alternative means of redress for consumers, but that these benefits may be offset by, among other issues, higher costs for firms (e.g. increased Professional Indemnity Insurance) that would likely be passed down to consumers. Unsurprisingly, the proposed PROA is controversial and, whilst it is heralded as benefitting the consumer, it is questionable whether most consumers would be prepared to incur the costs and increased time of proceedings when they already have recourse to the Financial Ombudsman Service.

What happens next?

Firms and their senior managers will no doubt be awaiting more clarity as soon as possible given that the scope of the Consultation Paper focuses on the broad proposals for the Consumer Duty as opposed to offering any substantive drafting. In the meantime, the FCA has encouraged firms to attend a webinar on the Consultation Paper on 10 July 2021 before the consultation closes to responses on 31 July 2021. After that, a further consultation paper to be published by the end of the year will set out the proposed text for any new rules, as well as the cost-benefit analysis. The new rules are expected to be in force by 31 July 2022.

As we await the detail, we recommend that firms do everything possible to get ahead of the curve, rather than waiting until the final rules are published. 31 July 2022 will come around very quickly. Firms should consider putting in place internal education processes of the forthcoming changes; assembling project teams; reviewing their websites and distribution models; and consider system upgrades. The Scout motto rings as true as ever: Be Prepared!

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