

CMS Financial Services Regulation Bitesize Briefings: Consumer Duty

The Consumer Duty Mindset and Consumer Understanding

Elisabeth Bremner, Partner

Sarah Brook, Partner

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Overview

In this session we are going to cover:

- The consumer duty mindset
- The consumer understanding framework
- Reviewing customer communications
- Testing customer communications

Consumer duty mindset

Consumers can only reasonably be expected to take responsibility for their choices and decisions if firms act openly and with honesty, avoid causing customers foreseeable harm and take proactive steps to empower consumers to make good choices by establishing an environment in which consumers can make decisions in their own interest and realise their financial objectives

Context

Complex and important decisions in a faster and increasingly complex environment

Focus on needs, characteristics and objectives of customers the Firm serves

Every stage of the customer journey

Vulnerable customers:

46% to 47% of UK adults with characteristics of vulnerability
Low financial resilience
Literacy & numeracy
Mental health
Physical health, cognitive decline
Life events

Financial Lives 2020:

10% of consumers 'strongly agreed' and 32% 'slightly agreed' that they had confidence in the UK financial services industry

Only 35% of respondents agreed that firms are honest and transparent in their dealings with them

Firms must understand and take account of cognitive and behavioural biases and the impact of characteristics of vulnerability and/or lack of knowledge on retail customers' needs and decisions

Behavioural Biases

Framework underpinned by work on behavioural biases

- Psychology of how customers actually behave and actually make decisions in practice
- Firms should understand and take account of behavioural biases and impact vulnerabilities can have on customer decisions and needs

What do firms know about:

- How their customers are making decisions – proactive and inactive?
- What their customers rely on to make those decisions? What are they reading / not reading? Who are they talking to?
- What helps/hinders them in making good decisions?

Out

- Excessive friction and sludges
- ‘Sludges’ – poor design that pushes into poor decision making:
 - barriers to using a product/service
 - barriers to exiting a product/service
 - complexity of structures and charges that hinder comparisons
 - unduly time consuming processes
 - insisting data sent in a particular format
 - poor handoffs
 - excessive delays etc

In

- Embracing biases in design
- Countering negative biases

Customer understanding framework

Customer Understanding

- Applies **before, during and after point of sale**
- **Includes interactions** between retail customers and the firm that **don't relate to a specific product**
- Includes **all channels** used or intended to be used for the communication: verbal, visual, written
- Must **ensure supports customer understanding**:
 - Meet information needs
 - Likely to be understood by the average customer intended to receive it
 - Equip customers to make effective decisions on a timely and properly informed basis
 - Must be clear, fair and not misleading
- **Tailor communications** according to:
 - Characteristics of customers intended to receive
 - Complexity of the product
 - Channel used
 - Whether advised / information

FCA wants consumers to be given the information they need, at the right time and presented in a way they can understand

The obligations apply to all firms involved in the production, approval or distribution of consumer communications, regardless of whether the firm has a direct relationship with the end customer

More than Principle 7:

- Focus on customer comprehension
- The right information, at the right time and in the right way
- Looking at the choice architecture – does it influence particular outcomes and if so, are those good outcomes?
- Tailoring communications where needed
- Testing, monitoring and adapting communications to support understanding and good outcomes

Foreseeable harm and consumer support

A firm must avoid causing foreseeable harm to retail customers

A firm must enable and support retail customers to pursue their financial objectives

- Firms **not permitted to hide behind ineffective disclosure** to say that customers had accepted the risks inherent in a product or service.
- Firms **must consider consumers' limited experience and behavioural biases** at all stages of the product lifecycle.
- Ongoing **monitoring and review** of communications and customer outcomes
- “Customers more likely to make decisions in their interests and achieve financial objectives when firms ensure products and services function as expected, give fair value, **firm communications are clear and don't create unreasonable barriers.**”
- Consider the characteristics of customers and **tailor communications** accordingly
- Help customers **navigate** information

Reviewing customer communications



Firms should 'put themselves in their customers' shoes' when considering whether their communications equip customers with the right information, at the right time, to understand the product or service in question and make effective decisions.



An effective decision will usually be one that maximises the likelihood of a customer achieving a good outcome



*Firms may consider their communications to be understandable, but that may only reflect the views of those involved in the design and sign-off of their communications – often **legal, compliance and other financial services professionals***



Effective communications are those which can be understood by the customers they are targeted at, not just those involved in their development

Reviewing customer communications



Non-handbook guidance

LAYERING

Key-information provided upfront with links to more detailed information

Key information should include key features, benefits, risks and costs + key actions and consequences of inaction

ENGAGING

Designed in a way that encourages customers to engage – especially if requires customer to act

Communications should be effective regardless of the channel of communication used. Digital communications should be compatible with different media.

RELEVANT

Appropriate level of detail for each communication

What does the customer need to know? What decision do they need to make? When do they need to know it? Where could confusion arise?

SIMPLE

Presented in a logical manner

Avoidance of jargon and technical terms
Explain meaning of key terms in plain and intelligible language

Build customer trust and enable easy comparison of options

WELL-TIMED

Communicate at appropriate touchpoints across product lifecycle e.g. at contract break points and provide opportunity to assess options and make effective decisions

Complex information and mandatory disclosures

- Should **continue to comply with legislative and regulatory disclosure** requirements
- **BUT consider what additional steps can take to support consumer understanding**: explain important information in a simple way upfront with signposting to more detailed information that may be a helpful reference at a later date
- Where prescribed framework or template for firms to follow, **consider if still some discretion** to decide what key information is or how to explain it AND if have some discretion, follow consumer duty guidance
- Outcome is also broader than specific disclosure requirements – must **consider communications as a whole** and ensure meet expectations

Testing customer communications

Customer testing

➤ **Firms required to test communications “where appropriate”**

➤ Proportionate approach to testing depending upon:

- The firm - size, resources and activities
- Relevant circumstances – product, customer and role
- Prioritise – those most likely to cause customer harm

➤ **Determining what to test:**

- Does it include key information designed to prompt or inform a decision?
- How important is the decision? What is the scope for harm?
- What other information has been provided on the same topic?
- How many customers does it impact?
- Could vulnerable customers be impacted?
- Is there a reason for urgency which overrides the need to test in advance?

➤ **All firms will need to be able to demonstrate they have an approach that delivers good outcomes**

➤ **Where firm identifies any issues – must:**

- Investigate
- Correct any deficiencies by adapting communications, or
- Modify products and processes (*e.g. sales processes*) if aware adapting communications not sufficient in isolation to support good outcomes

➤ **If firm aware a communication produced by another firm in the distribution chain is not delivering good outcomes, it must promptly notify the firm**

➤ **Must also notify the FCA if aware another firm in the distribution chain is or may not be complying with Principle 12**

Customer testing

FCA examples:

- Online experiments
- Customer feedback/surveys
- Customer interviews
- Customer focus group
- Specialist agency

Other available data?

- Complaints / FOS findings
- Customer feedback
- Social media
- Feedback from distributors
- File reviews, compliance reports, internal audit
- Business persistence
- Claims data
- Staff workshops/feedback
- Readability tools

If a decision is made not to test, how else can you evidence good customer understanding?

What is inclusive design?

- Designing a product, service, process or place so that it **can be accessed and works for everyone**
- If unable to design one solution that works for all, **offer choice for users** so that no-one is left at a disadvantage
- Can raise awareness through:
 - Discussing real-life customer stories
 - Inviting feedback and suggestions from customers so can improve products and services
 - Quick customer feedback surveys
 - Reviewing complaints
 - Talking to frontline staff
 - Talking to intermediaries
 - Talking to consumer bodies – reading reports and studies
 - Conducting customer focus groups
 - Collaborating with experts in behavioural science

Suggested Approach

Good Practice

- **Consistency** of descriptions across customer communications
- Information presented in **logical** manner
- **Engaging** design
- **Plain and intelligible** language
- **Summaries** of key terms illustrated with explanatory icons
- **Reducing amount of information given in one go**
- **Mandatory disclosures** – explain another way where don't meet outcomes
- Avoiding **unnecessary disclaimers**
- **Different strategies for different customer groups**
- Seek **regular customer feedback**
- Manufacturers seek **direct customer feedback** even where intermediaries involved
- **Execution-only sales** – check customer understanding and make aware advice is available
- **Simplify the product where testing doesn't meet outcomes**

Poor Practice

- Exploitation of **information asymmetries and behavioural biases**
- No attempt to help customers navigate the information
- Difficult for customers to identify key information and options
- **Solely relying on:** *'I have read the terms and conditions'* tick box
- **Design based on commercial efficiency, rather than information needs**
- **Customers left to work out which bits of the communication are relevant to them**
- Failure to consider **information needs after initial point of sale**
- Failure to adopt a **reasonable approach to testing:**
 - Not identifying communications where testing would be appropriate
 - **No reasonable basis to conclude that communications are likely to be understood by recipients**
- Failure to consider the fairness and clarity of contract terms
- Contracts contain **out of date material**
- Misleading information or misleading omissions
- **Information spread across different webpages**
- Too many links to different sections and pages
- **Information 'hidden away'** in legalistic T&Cs
- **Information provided too late** in customer journey
- Focus on component costs rather than cumulative costs
- Lack of a succinct comprehensive list of charges clearly signposted
- **Where FSCS protection doesn't apply, failing explain this and its implications**

A suggested approach

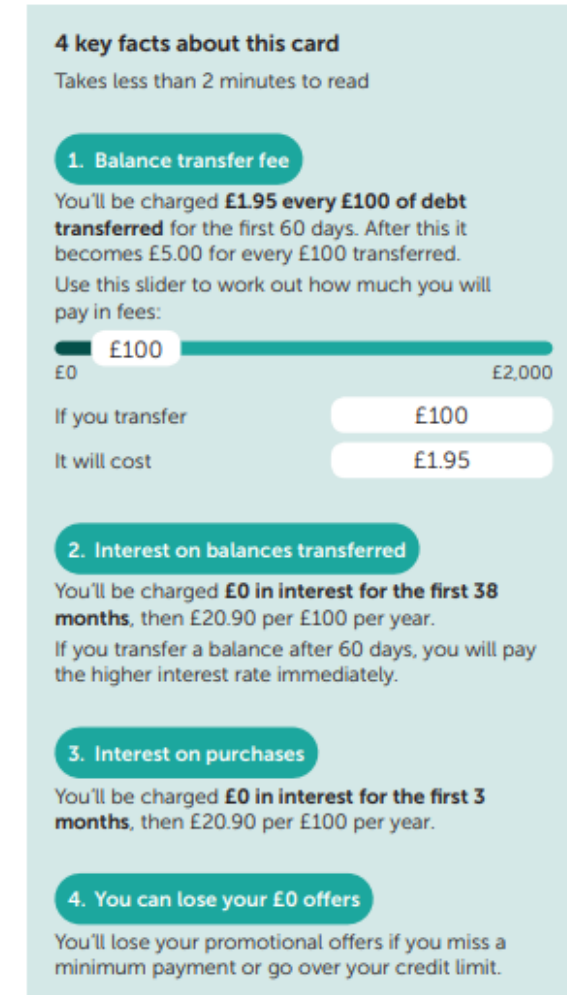
1. **Assess and record what good outcomes look like for the firm's customers in relation to their customer communications**
 - a. What does customer need to understand about the product, why and when?
 - b. Focus on whole journey, including post-sale
 - c. Determine if different customers = different needs
2. **Assess and record which communications have a material influence on customer decision making, and where the greatest risk of harm lies if customers do not properly understand**
 - a. Effect of communication might differ at different stages of the customer journey – e.g. will the customer need to return to it later?
3. **Prioritise the higher risk communications accordingly and record the rationale**
 - a. Known issues
 - b. Readability tools
 - c. Staff workshops (**not legal** / compliance / product design)
 - d. Intermediary workshops
4. **Consider existing sources of information firm has available to it about what their customers rely upon when making decisions and what they may be struggling to understand**
 - a. E.g. direct customer feedback, customer queries, any social media comments, complaints data, feedback from intermediaries
5. **Consider any external data on customer understanding of similar products and analogous data**
 - a. E.g. FCA studies such as on investment platform charges, FOS data, Which? reports, money marketing, readability tools, industry research etc.
6. **Determine where customer testing is appropriate and if so what kind of customer testing. Record the rationale for this.**
7. **Where determine testing not appropriate – determine basis of evidence of good outcomes. Record rationale.**

Some examples

Financial Capability Lab – credit cards

- An actual credit card application page used as a control
- Presented the most important information as ‘Four Key Facts’ (see Figure 7)
- Represented costs as pound values rather than percentages
- Added a reading cue that told participants it would take them less than two minutes to read the key facts
- Made the information interactive by adding a slider that provided feedback on the cost of transferring various balances.
- **21% increase in correct responses when compared with the control**

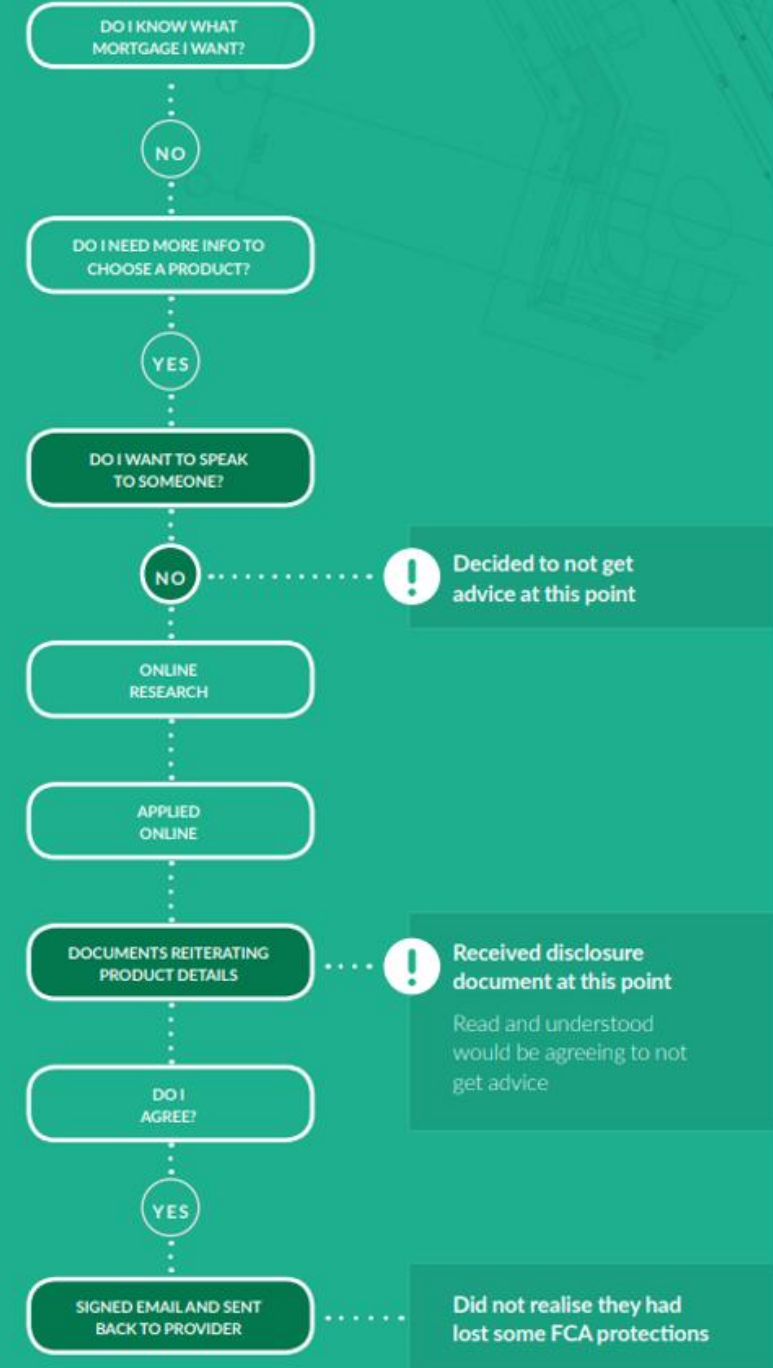
Figure 7: Example of 4 Key Facts box



Learnings from FCA study on buying a mortgage without advice:

- Found execution-only customers generally understood that they were selecting their mortgage without receiving advice
- BUT struggled to understand the disclosure documents that were tested and so did not understand the consequences of a decision to make an execution-only application
- DID NOT understand what protections would miss out on
- Customers take 'short-cuts' through an application process that feels long and complicated - so skim-read
- Risk of skipping over the execution-only disclosure document is significantly increased if given towards the end of the application process. By this stage, customers often simply want to 'get it done'
- Solutions?
 - Clearer and repeated signposting of execution only path
 - Repeating messages about the implications

A COMMON EXECUTION-ONLY CUSTOMER JOURNEY



FCA – mortgages execution only disclosures

- **Figures 2 and 3** are good, clear, definitions of terms.
- Customers also found it helpful to be given a definition of ‘advice’, so that they could make a straightforward comparison with execution-only

Execution-only

If you decide to switch your mortgage product with us online, you can choose for yourself which mortgage would best suit your needs. This is called buying on an ‘execution-only’ basis.

It means you are selecting the mortgage that fits your needs and we will not give you any advice or recommendations.

Figure 2

Advice: This is available through one of our mortgage advisers who will assess all your needs and recommend the right mortgage for you.

Execution-only: an execution-only mortgage means you are selecting a mortgage that is right for you. You are not receiving any advice or recommendation from us.

Figure 3

FCA – mortgages execution only disclosures

- Customers often feel that little thought has been put into how the document ‘feels’ to read. For instance **Figures 4 and 5 are examples of documents that are hard to read.**
- This means customers look only for information that feels most important to them and relates directly to their mortgage (such as checking the product they selected), skimming other information

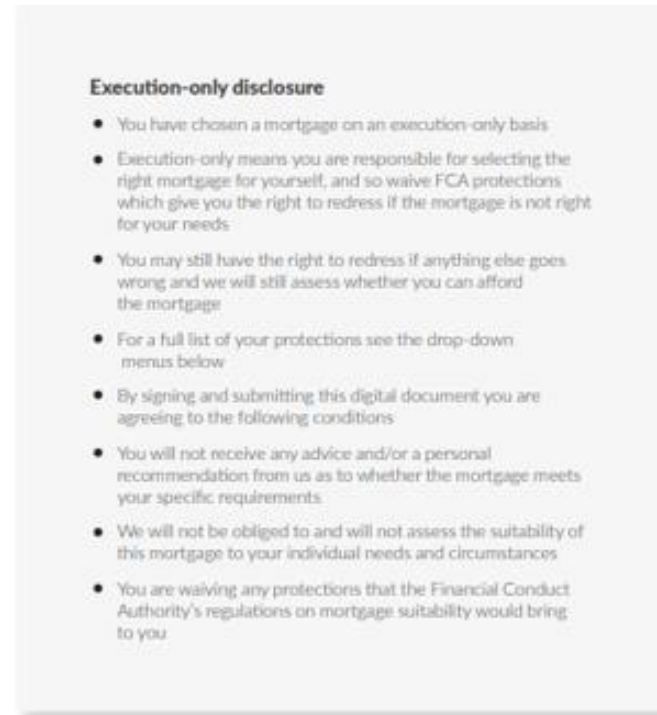


Figure 4

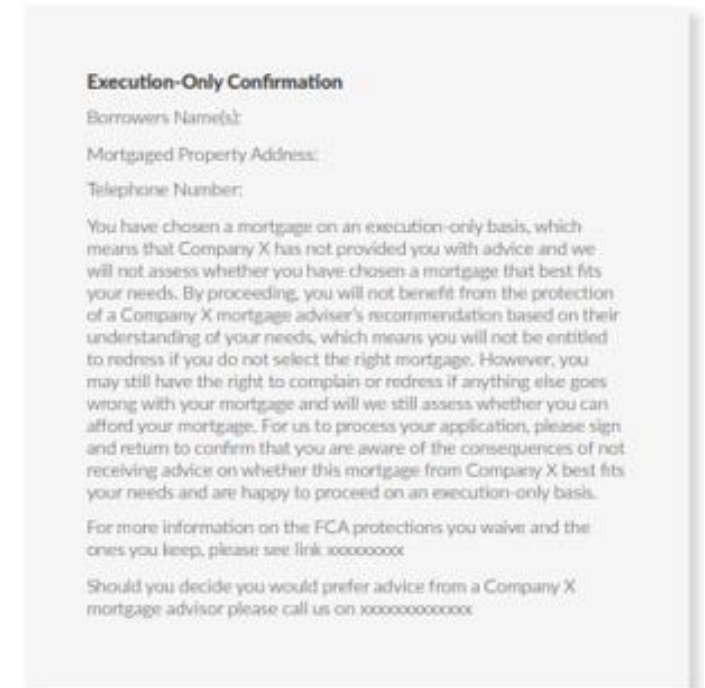


Figure 5

FCA – mortgages execution only disclosures

- A Q&A format makes the information more accessible
- Provides cues that help customer navigate important information

You have chosen to buy your mortgage without advice

Please read this document and then sign if you understand and agree to below.

What have I chosen?

You have chosen to buy your mortgage without any advice or recommendation from us, this means you are selecting the right mortgage for your needs. This is called buying a mortgage on an **'execution-only'** basis.

This means you will not receive some FCA protections on whether the mortgage is right for you.

Which FCA protections am I waiving?

[Insert answer]

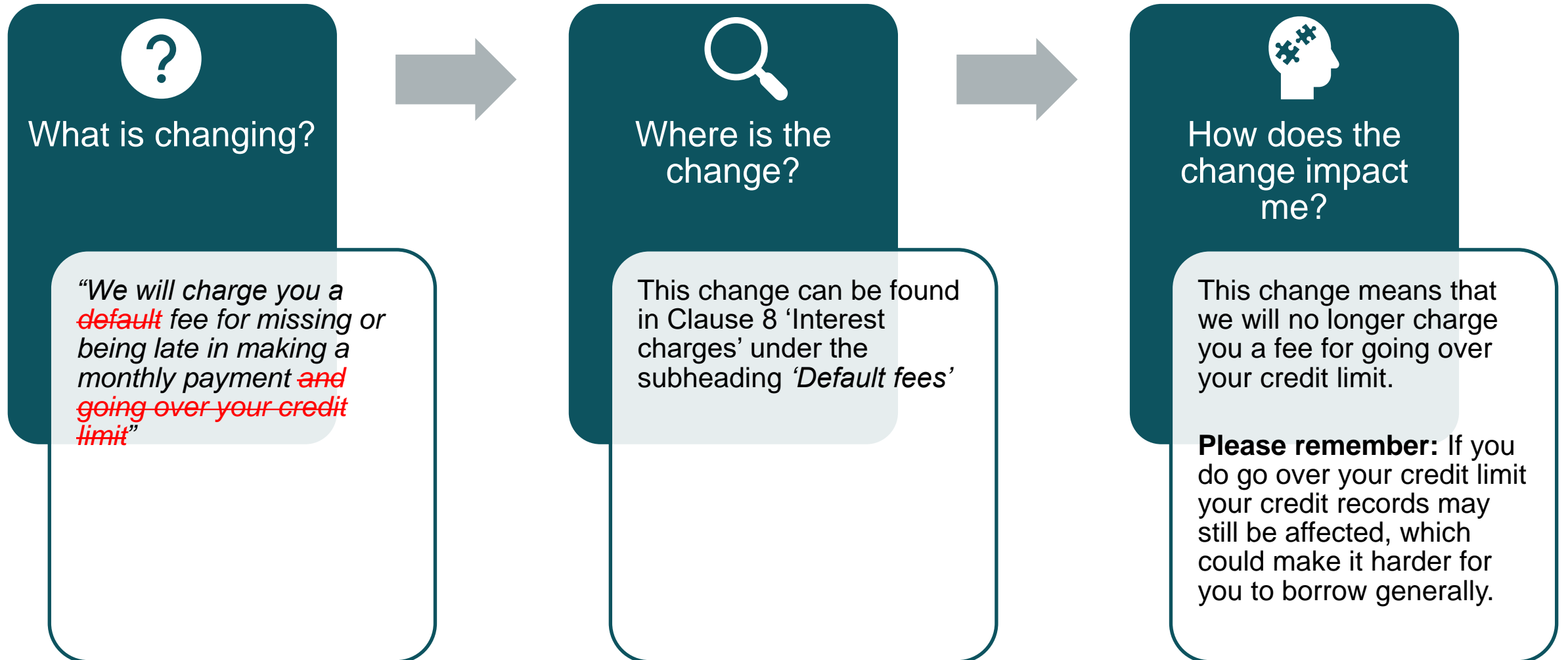
Which protections do I keep?

[Insert answer]

Where do I sign?

[Insert answer]

Changes to T&Cs



Definitions – can these be more accessible?

- For example, consider including definitions on the page where they are used

8. Pre-existing medical conditions

Before starting your **plan** you completed an application form in which you told us about your medical history. This information has been assessed by us to see if you have any **pre-existing medical conditions**.

Your **plan** does not cover **treatment of pre-existing medical conditions and related conditions**. We may review the exclusion of these conditions at your **renewal date** if you ask us to.

If you failed to provide us with full and accurate information in your application this may mean that we cannot cover a claim.

Definitions

Plan | the insurance contract between you and us, as set out in the latest version of this handbook.

Pre-existing medical conditions | medical conditions that you were aware of when you started the **plan**, whether or not these had been diagnosed.

Related conditions | Any symptom, disease, illness or injury which is considered, in our reasonable medical opinion, to be associated with any pre-existing medical conditions.

Renewal date | the annual anniversary of the date on which this **plan** started.

Treatment | surgical or medical services needed to diagnose, relieve or cure any disease, illness or injury.

People like us....



Example

Level cover

Let's assume Dave took out a plan for a term of 25 years, with level cover of £100,000. However 2 years before the end date of his plan he is diagnosed with a terminal illness, and asks us to pay out his amount of cover. We tell him that we will reduce the amount of cover by 3%. So we offer to pay a reduced amount of £97,000.

$$£100,000 \times 3\% = £3,000$$

$$£100,000 - £3,000 = £97,000$$

However Dave decided not to accept the reduced amount, as he was using his plan to cover an interest only mortgage, and needed the full amount covered to be paid to clear his mortgage. Sadly Dave died 7 months later, we paid out the full £100,000 (the amount of his cover).

Source: Fairer Finance (2017), 'The Fairer Finance guide to simple writing'.

Any questions? Please contact us...



Elisabeth Bremner | Partner

T +44 20 7367 3356

E elisabeth.bremner@cms.cmno.com



Sarah Brook | Partner

T +44 20 7367 3424

E sarah.brook@cms.cmno.com

Next time..

Join us at 9am on **17th May** where we will discuss **Outsourcing arrangements through the lens of the Consumer Duty** including:

- practical implications on a firm's outsourcing arrangements; and
- embedding the consumer duty in your supply chain management





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