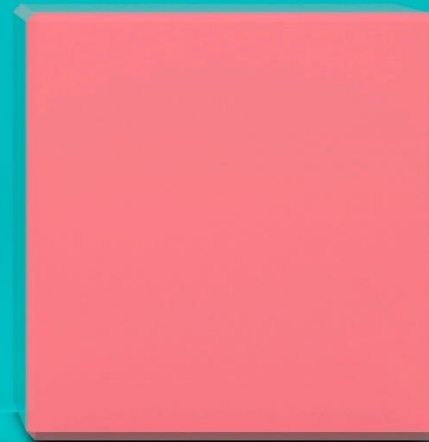


CMS Financial Services Regulation Bitesize Briefings: **Consumer Duty**

Unlocking the Consumer Duty – What will be in the FCA’s crosshairs?



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In this session we are going to cover:

- 01** Messages from the FCA on the prospect of it taking action for non-compliance with the Consumer Duty in the early stages after coming into force
- 02** Potential trigger points for early FCA action
- 03** Potential areas of focus for the FCA in the longer term that could lead it to take action

How will the FCA measure success?

- The FCA's published Strategy Paper for 2022-25 sets out four overarching outcomes that it expects all financial services firms to deliver when it comes to the treatment of consumers:



- The Consumer Duty is central to this strategy.
- How will the FCA know if the Duty and other steps the FCA is taking to protect customers are working?
The FCA has stated that it will measure success of the Duty through **metrics and by monitoring key outcomes for consumers.**
- One measure is that where consumers are getting products and services which meet their needs and provide fair value, this should lead to a **reduction in complaints upheld by the FOS** about fees or charges or being sold inappropriate products. It is, however, recognised that any reduction in complaints will lag behind changes to improve outcomes for consumers – there may even be a brief initial increase as consumer awareness of poor practice grows.
- The FCA has also indicated that it will “**measure what consumers are seeing and feeling**” and will be looking for an increase in the proportion of consumers, including vulnerable customers, who agree that most financial services firms are honest and transparent in the way they treat them (largely through its Financial Lives survey).

Financial Lives Survey Update – what consumers are currently experiencing

The FCA has published selected statistics on its Financial Lives cost of living (Jan 2023) recontact survey giving an insight into the financial situation UK adults experienced over the 6 months to January 2023. The summary findings were that:

The number of adults who missed payments on any domestic bills or meeting any of their credit commitments in 3 or more of the previous 6 months went up by 1.4 million: from 4.2 million (8%) in May 2022 to 5.6 million (11%) in January 2023.

29% of UK adults with a mortgage and 34% of renters experienced payment increases in the 6 months to January 2023.

The toll on mental wellbeing was considerable, with the FCA finding that just over 1 in 2 UK adults, or 28.4 million people, were more anxious or stressed due to the rising cost of living.

The number of people who felt that making these kinds of payments was a heavy burden jumped from 7.8 million (15%) to 10.9 million (21%).

Of UK adults who were insurance or protection policyholders in May 2022, 8% cancelled one or more of their policies, and 7% reduced the level of cover on one or more their policies – in the 6 months to January 2023, specifically to save money due to the rising cost of living. As some policyholders did both (cancelled and reduced cover), this means that 13% of May 2022 policyholders (or 6.2m people) cancelled and/or reduced cover.

The main report on the Financial Lives 2022 survey will be published this Summer


Messages from the FCA on the prospect of it taking action in the early stages after the Duty comes into force

Mixed messages from the FCA around whether it will take any action during the very early stages after the Duty comes into force on 31 July 2023



FCA Supervisors privately telling firms that the FCA is unlikely to take action in the early stages

Contrast



Strong public messages from the FCA that firms can expect robust action in the early stages, such as in the form of interventions or investigations, where it finds evidence of harm or risk of harm to consumers

The FCA is building up its Enforcement resources to coincide with the launch of the Duty

The FCA's Business Plan 2023/24 published in April states that the FCA will invest £5.3m on the Consumer Duty to ensure it is "embedded effectively"



**Potential trigger
points for early FCA action**

Triggers for early FCA action

- The Duty applies on a forward-looking basis from 31 July 2023 to firms' ongoing work for new and existing retail customers and their products or services that are open to sale or renewal.
- The FCA has made it clear that the Duty introduces a more outcomes-focused approach to consumer protection and sets higher expectations for the standard of care that firms give to customers. [Firms who flouted the old rules relating to fair customer treatment will clearly be at risk of early FCA action.](#)
- There are a [number of issues that might trigger FCA action in respect of the Duty](#) and these will depend upon the type of firm/sector. Some examples can be found in:
 - the FCA's published guidance on the Duty;
 - the FCA's feedback on its review of firms' Duty implementation plans (which provided examples of good practice and areas for improvement); and
 - the 19 Dear CEO/Directors letters each tailored to particular portfolios (the "[Portfolio Letters](#)") that the FCA sent to firms earlier this year setting out its concerns and expectations for firms operating in those portfolios.
- There are a number of potential triggers which do not say "Consumer Duty" on their face but will ultimately engage with the Duty directly, such as how firms respond to customers facing financial difficulties as a result of the cost of living crisis and whether banks pass on interest rates rises to customers in respect of savings as well as mortgages. Firms clearly also need to be aware of these and respond accordingly.
- If the FCA identifies a significant risk of customer detriment or detriment crystallises, FCA action will focus on / scrutinise the relevant firm's preparations for the Duty, in particular the adequacy of their implementation plans and their embedding of the Duty within their business.

Focus for portfolios – the Portfolio Letters I

The FCA has issued the Portfolio Letters outlining its expectations on the application of the Consumer Duty, across 19 different portfolios. The themes in the main bodies of the letters are broadly aligned. These letters are another clear warning to firms that the FCA is prepared to play tough. Common high level themes to be aware of are:

Pay attention to the Annexes - Insight on FCA expectations by sector are in the supporting Annexes. Firms must prioritise their plans by identifying and moving high risk areas to the top of the list. The Annexes indicate key areas for consideration.

Personal responsibility - The Duty holds individuals personally responsible for meeting expectations. There must be clear record of decision making and discussions. A clear audit trail will be essential for the firm and for Senior Managers' personal accountability.

Defining good customer outcomes - Firms must clearly understand their target market and the products and services they are providing. What 'good' looks like should be bespoke to what each firm does and the customers they serve.

Clear understanding of how the Duty applies - The Duty applies to all firms in the distribution chain for a product or service that will reach a retail customer i.e. all firms involved in the manufacture, provision, sale and ongoing administration and management of a product or service to the end retail customer. Firms must fully understand their role as a manufacturer and/or a distributor.

The importance of data - Firms need a clear data strategy which identifies the required data and relevant sources needed to evidence compliance with the Duty. This MI will not only be needed for internal assurance, but it is likely to be requested by the FCA for supervision as part of their "data led" strategy. Firms must work out what to use and when to ensure effective challenge and assurance.

Culture driving conduct - The FCA will look closely at what firms are doing to measure and improve their culture to deliver the right outcomes for customers.

Focus for portfolios – the Portfolio Letters II

Due diligence - Where a firm works with others in a distribution chain and conducts due diligence on those other firms, it should consider the Duty as part of that due diligence.

Monitoring ARs - Principal firms must ensure that they have appropriate controls in place to effectively oversee their ARs' activities and ensure that their ARs comply with the Duty.

Oversight of introducers - The FCA expects firms to have effective oversight of introducers, with additional scrutiny of any unregulated introducers.

Exploiting consumers behavioural biases - Firms must not design features of products or services to exploit the behavioural biases of consumers. For example, encouraging customers to take out, or make payment for products, using credit by giving greater prominence to a credit option, or making other options harder to find or access.

Business continuity/operational resilience - Firms should be able to continue providing a reasonable level of support to their customers in the event of an issue arising with their services, which might include temporary works, an IT outage, or cyber-attack

Please see the Annex for common themes in the Portfolio Letters relating to each of the four outcomes of the Duty

FCA announcements on work it will be doing on high-priority portfolios

The FCA has announced in some Portfolio Letters that its supervisory approach and next steps will see it using a variety of tools involving bilateral firm engagement, 'shallow' and 'deep' dives involving firm visits, and multi-firm work to focus on issues discussed in the Annexes to the portfolio letters. For example:

Mortgage Lenders and Administrators, and Retail Banks and Building Societies sectors:

- 1 From April 2023, engage a sample of firms in the sector:
 - a) on details of the frameworks and methodologies they have used to conduct their baselining and gap analyses on customer outcomes under the Duty
 - b) on specific instances of those baselines and gap analyses of particular products, services and customer journeys
- 2 From September 2023, engage a sample of firms in the sector on:
 - a) specific instances of changes they have made due to their baselining and gap analyses, including design and implementation of appropriate corrections
 - b) specific instances where they concluded that change was not needed because their baselining and gap analysis showed that the Duty was already being met
 - c) the enhanced data, indicators, and dashboards that firms should by then be starting to use to monitor customer outcomes against the Duty
- 3 From January 2024, engage a sample of firms in the sector on what their enhanced outcome-focused data and dashboards are now indicating about customer outcomes, and whether those outcomes are consistently meeting the Duty

Life Insurers sector:

- 1 Priority/targeted engagement with Life Insurers using outsourced service providers (OSPs) to a material extent for their customer servicing operations, as well as the FCA-regulated OSPs themselves, to understand how they have fully assured themselves that their businesses will achieve July 2023 compliance.
- 2 Priority/targeted engagement with firms that have material closed books about their planning for July 2024 compliance, particularly those using OSPs, but not limited to this.

In what form could FCA action take?

- The most likely form of FCA action shortly after the Duty comes into force will be **early intervention action** to provide an appropriate response before consumer harm is caused (or to minimise the harm caused) from a failure to comply with the requirements
- **Possible steps including:**
 - Requiring firm to provide information (a s.165 FSMA requirement);
 - Varying a firm's permissions to remove certain permissions (either through a 'VVOP' or by the FCA's own initiative 'OIVOP' power);
 - Placing requirements on a firm's permission (either voluntarily through a 'VREQ' or by the FCA's own initiative 'OIREQ' power);
 - Commissioning a skilled person report;
 - Obtaining attestations from Senior Managers at a firm; and
 - Banning financial promotions.
- There may also be some early enforcement referrals where the conduct and consumer harm is particularly serious



**Potential areas of focus for the FCA
in the longer term that could lead it to take action**

Longer term outlook

- In the longer term we can expect to see more enforcement action as the FCA's awareness of certain firms' failures to adequately implement the Duty grows, and the **FCA focuses on certain common themes / issues that have arisen since the Duty came into force** leading to potentially one or more thematic reviews on particular issues or portfolios
- The FCA's Portfolio Letters and the programme of work that Supervisors have already announced on high-priority portfolios provide an indication of the themes / issues that the FCA will focus on. For example, as mentioned, at the start of 2024 the FCA will engage a sample of firms in some sectors on what their enhanced outcome-focused data and dashboards are now indicating about customer outcomes, and whether those outcomes are consistently meeting the Duty. **This indicates that one key area that the FCA will focus on is the quality of data and MI being produced by firms on consumer outcomes**
- Other examples of areas the FCA may focus on as part of its supervisory / thematic work relating to the four outcomes under the Duty that could trigger FCA action are:
 - Firms who fail to identify appropriately their target market or continue to sell outside of the target market (Products and Services outcome);
 - Firms who fail to adequately review their charging models to deliver fair value to customers (Price and Value outcome);
 - Firms who fail to tailor their communications appropriately in accordance with the Duty (Consumer Understanding outcome); and
 - Firms who engage in 'sludge' practices to make it difficult for a customer to exit a product or service (Customer Support outcome)



**The importance of evidencing decision making
and actions taken to comply with the Duty**

[The importance of evidencing decision making]

- With the prospect of the FCA taking strong action to enforce compliance with the Duty, it is of crucial importance that firms evidence and retain a clear audit trail of all of the:
 - discussions held;
 - decisions they have made; and
 - the steps they have taken to implement the Duty
- This will provide the best means by which firms can demonstrate to the FCA that they have adequately implemented the Duty and are compliant with the requirements to avoid being subject to FCA action
- If the FCA does decide to take action, evidencing actions will assist in supporting the defences of firms' and their Senior Managers to rebut allegations of potential breaches

Any questions? Please contact us...



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Annex – Focus for portfolios and examples of poor practice

Focus for portfolios – Products and Services Outcome

Examples of common themes relating to the Products and Services Outcome

Clear target market	Firms must have identified a clear target market for their products and services at a sufficiently granular level.
Meet the needs of the target market	The design of products and services must meet the needs, characteristics and objectives of all groups within the target market, with due consideration being paid to any vulnerable customers.
Appropriate distribution strategy	The intended distribution strategy for the product or service must be appropriate for the target market.
Regular reviews	<p>Firms must carry out regular reviews to ensure that the product or service continues to meet the needs, characteristics and objectives of the target market, the distribution strategy remains appropriate, and the product or service is only being distributed to customers in the target market.</p> <p>If a firm identifies a potential issue during its regular review of a product or service or distribution arrangement, it must take appropriate steps to mitigate the situation and prevent any potential further harm.</p>
Adequate due diligence	Firms must carry out adequate due diligence on any investments they provide access to and evidence this.

Focus for portfolios – Products and Services Outcome

Examples of common themes relating to the Products and Services Outcome

Charging models	<p>Firms must review their charging models to deliver fair value to customers. They should consider whether the price different groups of consumers are paying is reasonable relative to the benefits they receive.</p> <p>If charging different prices to different groups of customers, the price must provide fair value to customers in each group.</p>
Consideration of fees consumers pay elsewhere in the value chain	<p><i>Manufacturers:</i> firms must carry out a value assessment of the product or service, considering its costs and benefits. They must consider the expected total price customers will pay, including all applicable fees and charges over the lifetime of the relationship. Where fair value is not provided firms must take appropriate action to mitigate and prevent harm, for example, by amending the product or service to improve its value.</p> <p><i>Distributors:</i> firms must carry out a value assessment to understand the outcome of the manufacturer’s assessment of value and ensure the distribution arrangements are consistent with the product or service providing fair value to customers. Firms need to consider if their own charges, when combined with the other charges a customer is paying – often referred to as the ‘total costs of solution’ – mean the product or service no longer provides fair value.</p>
Affordability	<p>Firms must not exploit consumer lack of knowledge or consumers with a limited ability to get products or services elsewhere, e.g., by charging unjustifiably/unreasonably high fees or interest rates to those with a poor credit history. Firms should consider their approach to affordability, in particular the requirement to avoid causing foreseeable harm. Inadequate assessment of affordability is predictably likely to cause customer harm.</p>

Focus for portfolios – Consumer Understanding Outcome

Common themes relating to the Consumer Understanding Outcome

Communications that support consumer understanding

Firms' communications must enable consumers to understand their products and services, and applies before, during and after the point of sale.

It includes all interactions between retail consumers and the firm that do not relate to a specific product.

Firms must ensure that communications: (a) support the information needs of consumers; (b) are likely to be understood by the average consumer intended to receive it; (c) equip consumers to make effective decisions on a timely and properly informed basis; and (d) are clear, fair and not misleading.

Forms of communication

It applies to all forms / channels of communication, whether verbal, visual or in writing.

Tailoring communications

Communications must be tailored according to: (a) the characteristics of the consumers intended to receive them, including characteristics of vulnerability; (b) the complexity of the products; (c) channel used; and (d) whether advised or information only.

Testing and monitoring

Firms must test, monitor and adapt communications to support understanding and good outcomes for consumers.

Focus for portfolios – Consumer Support Outcome

Common themes relating to the Consumer Understanding Outcome

Support at every stage of the lifecycle

Firms must provide support that meets the needs of consumers, throughout the life of the product or service, whether the customer makes an enquiry, complaint or wants to switch provider.

It should be at least as easy to switch or cancel products, leave a service or make changes, as it is to buy the product or service in the first place. For example, firms must avoid 'sludge' practices that can make it more difficult for a customer to exit a product or service than to enter into one.

In addition, the quality of customer support post-sale should be as good as it was pre-sale.

Avoiding foreseeable harm

Firms must ensure they have processes in place to avoid causing foreseeable harm and act in good faith when they identify that they have caused harm (either through action or inaction), and to take appropriate proactive action to rectify the situation, which may include redress.

Consideration of complaints

Firms should be considering the wider implications of individual complaints and whether they indicate systemic failures which will require a more holistic approach

FCA guidance examples of poor practice/ inconsistent actions (FG22/5)

Products and Services Outcome	Products designed with aspects that exploit behavioural biases. E.g. complex investment products where the complexity disguises high risks / costs, or poor prospects of the product delivering a commensurate return.
Price and Value Outcome	Pricing practices that give no consideration to whether the product / service offers reasonable benefits in relation to the total price paid.
Consumer Understanding Outcome	Communications from banks that encourage customers to focus on the daily cost of an overdraft (which appear small) rather than the significant cumulative cost of borrowing.
Consumer Support Outcome	Using an automated telephone system as part of consumer support that only provides options to progress with queries regarding a few commonly raised issues. There is no route for customers to seek support regarding other issues. As a result, some customers are unable to obtain the support / information they need.



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