

CP21/36 A New Consumer Duty

**Feedback to CP21/13 and further
consultation**

December 2021

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Document History

Revision History

Version	Date	Description	Reviewer
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Distribution

Description
Firms
IFAC Ltd

Latest Updates

Document Information

Background

This document provides a summary of CP21/36 A New Consumer Duty Consultation Paper. This document is designed to provide high level information to relevant parties and ensure that everyone is up to date with FCA Guidance and Consultations.

Purpose

This guide is intended solely for use by IFAC and its clients and lays out the FCA guidance and useful processes and policies to implement. It would be useful for:

- Compliance
- T&C
- Firms and Individuals

Useful Information

The FCA are asking for comments on this by 15 February 2022.

They expect to publish the policy statement summarising responses and to make any new rules by 31 July 2022

The easiest way to make comments is on the response form at www.fca.org.uk/cp21-36-response-form

The full Consultation Paper is at <https://www.fca.org.uk/publication/consultation/cp21-36.pdf>

Summary

Why is the FCA consulting?

The FCA wish to bring in clearer and higher standards of care towards consumers beyond the current set of Principles and Rules. They want all firms to be putting consumers at the heart of their businesses, offering products and services that are fit for purpose and which they know represent fair value.

Who this applies to

- regulated firms, including electronic money institutions, payment institutions and registered account information service providers
- consumer groups and individual consumers
- industry groups / trade bodies
- policy makers and regulatory bodies
- industry experts and commentators
- academics and think tanks

This guidance is centred on the role of financial advisers.

The scope of the consumer duty

Retail Scope

In CP21/13, we proposed that the Consumer Duty would apply to all ‘retail clients’. This section sets out the proposed scope of the consumer duty.

Following feedback, the FCA recognise that applying a single standard retail client definition to the Consumer Duty could create challenges in different sectors. Currently, certain larger SMEs are in scope of Principle 6, but out of scope of any detailed Handbook rules. Applying the Consumer Duty, which is a package of both a Principles and Rules, would therefore have a significant impact and we agree this would be disproportionate. It could also lead to a confusing picture of protections for SMEs in scope of the Consumer Duty but not our Handbook rules.

The Consumer Duty is now proposed to align the scope with the existing scope of the FCA’s sectoral sourcebooks. For example, for insurance, the scope of the Consumer Duty will follow the position in the Insurance Conduct of Business Sourcebook (ICOBS). For mortgages, the Consumer Duty would follow the position in the Mortgage Conduct Business Sourcebook (MCOB).

The Duty would apply to firms dealing with HNW clients, unless it takes conduct outside of the regulatory perimeter i.e., promotion restrictions do not apply to certain promotions for certified HNW clients.

The Duty will also apply to prospective clients.

Application of the Consumer Duty through the distribution chain

In CP21/13, the FCA proposed that the Consumer Duty would apply to all firms in the distribution chain that can influence material aspects of the design, target market or performance of a retail financial services product or service.

The proposed rules will apply proportionately and there will be no expectation for firms to oversee the action of other firms in the distribution chain. Firms will be responsible only for their own activities.

Naturally, it is expected that firms with a direct relationship to the end client will have the greatest responsibility under the Consumer Duty.

Firms in the wholesale sector

In CP21/13, the FCA said that ‘some firms that operate exclusively in wholesale markets as part of a distribution chain for retail products or services would be subject to the Consumer Duty’.

The FCA propose that the Duty would apply to firms that have a material influence over:

- the design or operation of retail products or services, including their price and value
- the distribution of retail products or services
- preparing and approving communications that are to be issued to retail clients, or
- direct contact with retail clients on behalf of another firm, such as firms involved in debt collection or mortgage administration

For example, an investment bank that designs a structured product for sale to retail customers would be subject to the Consumer Duty but investment banks providing wholesale instruments as component parts of a product created by a third-party firm would not.

The FCA are proposing to exclude from the scope of the Consumer Duty activities that involve the issuance of non-complex financial instruments and non-retail financial instruments.

Unregulated activities

As with other FCA rules, the Consumer Duty would only apply to activities within our remit. It would not apply to activities outside our perimeter, which is set by Parliament, or to pension schemes regulated by TPR.

The FCA are however taking a similar approach to current principles by proposing that the Duty would apply to unregulated activities that are ancillary to regulated activities. For example, this could include activities in relation to product design or payment services and issuing of e-money.

Authorised firms approving financial promotions for unauthorised third parties will be subject to the Consumer Duty and would need to consider this.

Where authorised firms outsource activities to unauthorised third parties, the firm would need to consider the risks involved and ensure they are appropriately addressed and managed. The authorised firm remains fully responsible for compliance with our rules in this scenario.

Application outside of the UK

To manage risks, where part of the chain is outside the UK, the FCA propose to require UK distributors of non-UK products and services to take all reasonable steps to comply with the products and services outcome.

There are specific issues to consider for firms in Gibraltar selling into the UK and firms in the temporary permissions regime and financial services contract scheme following the UK's withdrawal from the EU. In the future, a new permanent legislative framework – the Gibraltar Authorisation Regime (GAR) – will be established.

The UK left the EU on 31 January 2020 and has a temporary permissions regime to allow EEA firms to continue operating in the UK within the scope of their permissions for a limited period, while seeking full UK authorisation, if necessary. The FCA propose to apply the Consumer Duty to firms in the temporary permissions regime, whether these firms are doing regulated business from an establishment in the UK or on a services basis, as well as to firms authorised in the UK. The application of the Consumer Duty to firms in the temporary permissions regime will include firms in supervised run-off under the financial services existing contracts regime.

The Consumer Duty will apply to UK firms dealing with non-UK individuals.

Application to existing products and services

Proposed application of the Consumer Duty to existing products and services

In CP21/13, the FCA confirmed that the Consumer Duty would not apply retrospectively to past business. The proposed rules for the Consumer Duty would therefore not apply to firms' past actions.

The Consumer Duty would however apply, on a forward-looking basis, to existing products or services and which are either:

- still being sold to customers, or
- closed products or services that are not being sold or renewed

Firms will need to comply with the Consumer Duty in full for any products or services sold or renewed after the Consumer Duty comes into effect. Firms would need to review their products and services during the implementation period. This might mean a firm needs to update the 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.

Following the implementation period, firms would need to comply with the Consumer Duty on a forward-looking basis for customers with existing contracts.

Firms would not be expected to apply the rules to closed products or services where they are not relevant. Firms should identify if they meet the cross-cutting rules.

The Consumer Duty and Consumer Principle

The proposed structure of the Consumer Duty

In CP21/13, the FCA proposed that there would be 3 elements to the Consumer Duty. There are no proposed changes to that.

- **A Consumer Principle** which reflects the overall standards of behaviour that the FCA want from firms, and which is developed by the other elements of the Consumer Duty.
- **Cross-cutting rules** which develop our overarching expectations that apply across all areas of firm conduct.
- **Four outcomes** which give more detailed expectations for the key elements of the firm-consumer relationship.

The Consumer Duty is in relation to “Retail Clients” only.

The Consumer Principle

In CP21/13, the FCA consulted on 2 options for the wording

Option 1: A firm must act to deliver good outcomes for retail clients

Option 2: A firm must act in the best interests of retail clients.

The FCA have selected to proceed with Option 1 for the wording of the new principle.

A firm must act to deliver good outcomes for retail clients

The proposed wording reflects the shift the FCA want to see and the expectation for firms to consistently focus on consumer outcomes and putting consumers in a position where they can act and make decisions in their own interests.

The FCA focus is on firm’s acting reasonably to ensure good outcomes.

Consumer Duty Structure



How the Consumer Principle would fit with existing principles

At present, the FCA have requirements in Principles 6 and 7 for:

- **Principle 6:** A firm must pay due regard to the interests of its customers and treat them fairly.
- **Principle 7:** A firm must pay due regard to the information needs of its clients and communicate information to them in a way which is clear, fair and not misleading.

In CP21/13, the FCA highlighted that the Consumer Duty would overlap with existing Principles, particularly Principles 6 and 7, as well as the Treating Customers Fairly (TCF) outcomes.

Principles 6 and 7 would continue to apply to firms dealing with wholesale or retail customers outside the scope of the Consumer Duty, i.e., certain SMEs and wholesale business.

Although the FCA propose to disapply Principles 6 and 7 where the Consumer Duty applies, they think there is merit in retaining the Handbook and non-Handbook material linked to them at this time. So, they have proposed draft guidance in the Handbook explaining that:

- The Consumer Principle imposes a higher standard of conduct than Principles 6 and 7
- While existing guidance on Principles 6 and 7 will remain relevant to firms in considering their obligations under the Consumer Duty, firms should take account of the inherent limits of such guidance as they do not cover our expectations under the Consumer Duty in full
- Failure to act in accordance with existing guidance on Principles 6 and 7 which would have amounted to a breach of those Principles, is likely to breach the Consumer Duty
- Where a firm is acting in accordance with guidance on Principles 6 and 7, this should not be relied upon alone in considering how to comply with the Consumer Duty. Firms will also need to consider all their obligations not only under the Principles but under any other applicable other FCA rules

The Cross-Cutting Rules

As part of the Consumer Duty, the FCA proposed a set of cross-cutting Handbook rules to develop and strengthen the standards of conduct that we expect under the Consumer Principle.

The cross-cutting rules proposed in CP21/13 required firms to:

- act in good faith towards retail customers, and
- take all reasonable steps to:
 - avoid causing foreseeable harm to retail customers, and
 - enable retail customers to pursue their financial objectives

Financial Objectives

The FCA are proposing to introduce the Cross-Cutting rules with a few amendments.

The proposed cross-cutting rules require firms to:

- act in good faith towards retail customers, and
- avoid causing foreseeable harm to retail customers, and
- enable and support retail customers to pursue their financial objectives

There is no proposal to add further cross-cutting rules in relation to vulnerable consumers. The draft rules instead embed consideration of these consumers at every part of the journey.

All reasonable steps

The FCA have removed the reference to “all reasonable steps” as they believe it is not the best way to achieve the aims of the Duty.

The entire Duty is underpinned by the concept of reasonableness.

Foreseeable harm

As with the headline Principle, the duty does not require firms to protect customer from:

- unforeseeable harm
- all poor outcomes, or
- risks that the customer reasonably understood and accepted

Financial objectives

The FCA have amended the cross-cutting rules to reflect the focus on enabling and supporting consumers to make effective choices for themselves and enjoy the use of the product and service they have purchased.

Where Execution Only is used by a firm, it can be assumed their customers' objective to be the enjoyment and use of the product and service they have purchased.

Where advice or discretionary services are used by a firm must act on the knowledge they have from obtaining information in relation to their objectives.

The products and services outcome

In CP21/13, the FCA set out proposals for all firms in the distribution chain to consider issues related to product or service design, distribution strategies and ongoing monitoring and asked respondents for their views.

Proposed requirements for the products and services outcome

The FCA are proposing to set different requirements depending on their role in the distribution chain.

- Manufacturers – firms that create, develop, design, issue, operate or underwrite a product or service
 - It is possible for intermediaries to be manufacturers i.e., if they set the parameters of a product and commission other firms to build it
- Distributors – firms that offer, sell, recommend, advise on, propose or provide a product or service

Proposed requirements for manufacturers

We are proposing to introduce requirements for manufacturers, including the need to:

- develop an approval process for products or services
- identify a target market of consumers for whose needs, characteristics and objectives the product or service is compatible
- consider if there are any consumers with characteristics of vulnerability in the target market and take account of any additional or different needs of those consumers
- test the product or service and ensure it is designed to meet the needs, characteristics and objectives of the target market
- select distribution channels that are appropriate for the target market and provide adequate information to distributors to enable them to understand the product or service and the target market, and
- regularly review the product or service and its distribution, and take appropriate action to mitigate the situation if they identify circumstances that may adversely affect their customers

This would apply for new products and services, and where there is significant adaptation of existing products or service.

Proposed requirements for distributors

The FCA propose to introduce requirements for distributors, including the need to:

- develop distribution arrangements for each product or service distributed
- get information from the manufacturer to understand the product or service, its target market and its intended distribution strategy, and
- regularly review the distribution arrangements to ensure they are appropriate and, if they identify issues, take appropriate action to mitigate the situation and prevent any further harm

The Price and Value outcome

In CP21/13, the FCA outlined the high-level approach we intended to introduce and asked respondents for their views.

The FCA do not propose that firms must charge the same price to all consumers. Differential pricing between new and existing customers in the form of clear, transparent up-front discounts for new customers are not prohibited by the Consumer Duty. However other practices, such as complex and opaque pricing techniques or engaging in practices that discourage customers from shopping around, are unlikely to be consistent with the Consumer Duty.

Where firms charge different prices to different groups of customers, the FCA expect them to provide fair value for each group. Extra consideration should be paid to consumers who have characteristics of vulnerability or share protected characteristics under the Equality Act 2010 and may be disadvantaged.

The proposals set out that firms should consider cognitive and behavioural biases and potential vulnerabilities and avoid exploiting these factors.

The specific focus of the price and value outcome rules is on the relationship between the price the consumer pays to the overall benefits they can reasonably expect to obtain from a product. Value needs to be considered in the round and low prices do not always mean fair value. The FCA expect firms to think about price when assessing fair value but not at the expense of other factors.

Under the proposals, firms would need to consider the role they play in the value chain and how this affects the price the consumer pays. Firms, including those in the e-money and payment sector, which do not directly interact with consumers, can still have an impact on value. Clearly communicated pricing structures help, but firms should not rely on individual customers' willingness to buy the product or service as evidence of fair value.

Requirements for a firm:

- Set prices so that they represent fair value (the overall price and benefits) for their target customers
- Value to consider:
 - The nature of the product
 - The type and quality of services provided to customers
 - The expected total price the customer will pay

Proposed requirements for the price and value outcome

For manufacturers, the FCA propose that the assessment of whether the price of a product/service provides fair value must include consideration at least of:

- the nature of the product or service, including the benefits that will be provided or that consumers may reasonably expect, and their quality
- any limitations that are part of the product/service,
- the expected total price customers will pay, and
- any characteristics of vulnerability in the target market for the product or service

Distributor must not distribute products without obtaining information from the manufacturer to understand the intended value of the product or service and considering the impact distribution can have on the value. This will ensure the product or service provide fair value.

Value assessments should be regularly reviewed.

The consumer understanding outcome

In CP21/13, the FCA set out proposals for all firms to:

- communicate in a way that is reasonably likely to be understood and that facilitates decision-making, and
- take proportionate steps to review, and where appropriate, test communications to show the firm has taken reasonable steps to ensure they are reasonably likely to be understood and facilitate customers' decision-making

The FCA propose to rename this outcome "Consumer Understanding" from the previous proposal of "Communications"

Requirements for a firm:

- Communicate in a way that it reasonably likely to be understood and that facilitates decision making
 - Taking into account the likely recipients of the communication with particular care given to vulnerable consumers
 - At every stage of the lifecycle – from marketing to sale and post sale service
 - Taking into account the complexity of the product or service and the channels of communication
 - In a timely manner
- Take proportionate steps to review, test and adapt (where appropriate) communications to ensure they are likely to be understood and facilitate customers' decision making

Proposed requirements for the consumer understanding outcome

Following analysis of responses to CP21/13, the FCA are consulting on rules that would require firms to ensure they:

- support retail consumer understanding so that their communications:
 - meet the information needs of customers
 - are likely to be understood by the average customer intended to receive the communication, and
 - equip customers to make decisions that are effective, timely and properly informed
- communicate information to retail customers in a way which is clear, fair and not misleading
- tailor communications taking into account the characteristics of the retail customers intended to receive the communication (including any characteristics of vulnerability), the complexity of the product, the communication channel used, and the role of the firm
- provide information to retail customers that is accurate, relevant and on a timely basis
- tailor communications to meet the information needs of individual customers and check the customer understands the information, where appropriate, when a firm is interacting directly with a customer on a one-to-one basis, and
- monitor, test and adapt communications to support understanding and good outcomes for retail customers

The consumer support outcome

In CP21/13, the FCA set out proposals for all firms to consider issues involving their customer service to consumers. These were, in summary, that firms should:

- consider the customer service needs of their customer base
- design processes in a way that actively takes the consumers' needs into account, and not deliberately design processes that cause undue hindrance or cost on consumers, and
- monitor the performance of and regularly review processes

Proposed requirements for the consumer support outcome

Following analysis of responses to CP21/13, the FCA are consulting on rules that would require firms to ensure

- they provide an appropriate standard of support to retail customers such that it meets the needs of customers, including those with characteristics of vulnerability
- retail customers can use products as reasonably anticipated
- retail customers do not face unreasonable barriers (including unreasonable additional costs) when they want to pursue their financial objectives, and
- regularly monitor whether they are providing an appropriate standard of support that meets the needs of – and does not disadvantage – retail customers, including those with characteristics of vulnerability

Consumers in vulnerable circumstances

There have been no new proposals in this section, however the FCA are looking for views on whether the proposed rules and guidance on the Consumer Duty go far enough in ensuring that firms consider the diverse needs of consumers, or whether there would be support for us to make more explicit reference to diversity and inclusion within each of the main elements of the Consumer Duty, for example where we discuss product manufacture, disadvantaged consumers and tailoring communications.

They would also be interested in views on whether it would be useful to provide further rules or guidance on the interaction between diversity characteristics and our existing definition of vulnerability to provide greater clarity around the characteristics needing additional consideration.

A Private Right of Action (PROA)

In CP21/13, the FCA explained that, in their view, a PROA is part of a wider range of mechanisms which make firms accountable for their breaches of our rules, and by which consumers can get redress. This includes firms' own complaints and redress procedures, our supervisory and enforcement activities, access to redress through the Financial Ombudsman, other redress schemes and the Financial Services Compensation Scheme (FSCS).

There is no specific proposal to introduce a PROA for breaches of the FCA Principles at this stage.

Implementation timetable

The Consumer Duty is a significant change and a unique regulatory intervention, which:

- affects all retail firms, products and services
- requires firms to focus on matters of market conduct that involve complexity and judgment – such as fair value, unfairness, and sludge practices, and
- comes at a time of significant wider market and economic change

Based on this, and analysis of responses to CP21/13, the FCA consider at this stage, firms should have until 30 April 2023 to fully implement the Consumer Duty. They are however keen to hear the views of respondents on this now that they have seen the full package.

Monitoring and the FCA's approach to the Consumer Duty

Under the Consumer Duty the FCA would expect firms to:

- monitor and regularly review the outcomes that their customers are experiencing
- ensure that the products and services they provide are delivering the outcomes that they expect in line with the Consumer Duty, and
- identify where they are leading to poor outcomes or harm to consumers

Through the monitoring of consumer outcomes, the FCA would expect firms to:

- identify and manage any risks to good outcomes for consumers
- spot where consumers are getting poor outcomes, and understand the root cause
- have processes in place to adapt and change products/services or policies/practices to address any risks or issues as appropriate, and
- to be able to demonstrate how they have identified and addressed issues leading to poor outcomes

The FCA do not propose to require firms to report on specific metrics, but firms need to ensure that they can demonstrate effectively how they are monitoring the outcomes that their customers receive, identifying harm or risk of harm and addressing the issues that they identify.

If asked, firms would be expected to be able to explain how they reached a decision on the most appropriate intervention, demonstrate how it has addressed the concerns that they

identified, and delivered good consumer outcomes and, if it has not, what they have done further to address the issue.

Governance

The FCA would expect a firm's board, or equivalent management body, to consider a report from the firm assessing whether it is acting to deliver good outcomes for its customers which are consistent with the Consumer Duty, at least annually.

This assessment should include:

- the results of any monitoring that the firm has undertaken to assess whether their products and services are delivering the outcomes that they expected
- new and emerging risks to good outcomes for consumers
- any evidence of consumers or groups of consumers who are not achieving good outcomes and an evaluation of the impact and the root cause
- any evidence of consumers or groups of consumers who have characteristics of vulnerability and are not achieving good outcomes
- actions taken to address any risks or issues, and
- whether the firm's future business strategy is consistent with it acting to deliver good outcomes under the Consumer Duty

Before signing off the assessment, the board or governing body should agree the action required to address any issues which are impacting the firm's ability to act to deliver good outcomes and agree whether any changes to the firm's future business strategy are required.

What firms should monitor

Firms should produce Management Information (MI) on consumer outcomes. It should be appropriate in nature, scale and complexity of the business, and should consider the clients served and products and services offered.

There is no specified record keeping requirement for this, however firms should ensure that this is in line with standard FCA record-keeping rules. The types of data are not being stipulated nor are there any requests for this to be submitted to the FCA, however it should be available should the FCA request it.

Types of information firms may want to collect include:

- **Business persistence**
 - analysis of customer retention records – e.g., claims and cancellation rates and details of why customers leave. This may flag where poor treatment is contributing to high turnover of customers.
- **Distribution of legacy products/pricing and fees and charges**
 - review of whether these consumers are more likely to pay particular fees and charges or are getting outcomes that are worse than other customers.
- **Behavioural insights**
 - consumer interactions and drop off rates; use of different communication channels including digital; consumer testing of financial promotions. This may flag where firms need to improve policies, processes and systems (e.g., where there are barriers to consumer engagement or understanding).

- **Training and competence records**
 - analysis of records of staff training, including remedial actions where staff knowledge or actions are found to be below expectations.
- **File reviews**
 - reviewing customer files and monitoring calls to check for errors and assess if customers received good outcomes (this is particularly useful for sales processes).
- **Customer feedback**
 - using formal and informal feedback from customers to identify trends and areas for improvement (e.g., complaints and comments made to the firm but also comments and complaints on social media).
- **Numbers of complaints**
 - trends in numbers of complaints involving poor consumer outcomes through the consumer-firm relationship.
- **Complaint root cause analysis**
 - investigating complaints fully to understand the cause of customer complaints, not just dealing with the symptoms.
- **Complaints data** (together with ensuring it is easy for consumers to make complaints, and that they can make complaints through multiple channels).
- **Outcome reviews**
 - the 4 outcomes include requirements for firms to review standards over time. The results of these reviews, together with any action taken would be relevant for consideration of whether the outcomes are being followed.
- **Compliance reports**
 - review compliance reports to check if standards are being met.
- **Testing customer experiences** through processes such as mystery shopping, auditing, focus groups and deep dives.
- **Allowing staff to feedback honestly** when they think processes could be improved.
- **Reviewing whether processes and policies are effective** in delivering good outcomes for consumers.

The Senior Managers and Certification Regime

The FCA propose to amend our SM&CR individual conduct rules in our Code of Conduct sourcebook (COCON) to reflect the higher standard of the 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 individual conduct Rule 4, which requires conduct rules staff to ‘pay due regard to the interests of customers and treat them fairly’, would not apply.

We are also proposing to include obligations as part of this new individual conduct rule that reflect the Consumer Duty’s cross-cutting rules. This means that, where the new rule applies, conduct rules staff will be required to:

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